

# **Housing Policy Reform in South Africa: International Perspectives and Domestic Imperatives**

Stephen K. Mayo  
Principal Economist  
Urban Development Division  
The World Bank<sup>1/</sup>

As South Africa confronts the momentous social and economic changes being played out today, its prospects for achieving a just and sustainable transition toward a new society depend critically on how it deals with the so-called "housing problem". The intent of this paper is to present an outsider's perspective on both the nature of the housing problem confronting South Africa today and on some of the key elements that can be used to define a strategy for dealing with the problem. In discussing some of the strategic options, examples of successful and unsuccessful housing strategies and programs in a number of other countries are presented. Finally, the paper discusses several aspects of the potential role of international institutions such as the World Bank and bilateral aid agencies which can help in defining and implementing a successful housing strategy for South Africa.

## **South African Housing Sector Performance in International Perspective**

In a previous paper, work done as part of a joint program of the United Nations Centre for Human Settlements and the World Bank (the Housing Indicators Program) was used to illustrate how a number of key aspects of the South African housing sector stack up against expected international norms for countries at about the same level of economic development as South Africa.<sup>2/</sup> In that paper, as well as in various background pieces written in conjunction with World Bank visits to South Africa, a relatively clear picture of both the extent and the causes of the South African housing problem has emerged. At the same time, a sense of the stakes of policy reform, both for the housing sector and for the broader economy, has been clarified.

From such analyses, one overriding issue recurs. It is simply this: At present the housing sector in South Africa is highly distorted, with major implications for the performance of the economy, the economic efficiency of cities, the economic welfare of non-whites, and the performance of the housing sector itself. These distortions have had the effect of defining a set of rules and incentives which fundamentally alter the way that the housing sector functions in South Africa relative to its behavior in other countries. Moreover, it is clear that the rules and incentives which govern housing sector performance affect different housing outcomes to different degrees, with quite different costs to individuals and society. Without a clear understanding of the most costly dimensions of the underperformance of the housing sector, including costs that extend beyond the sector to the broader economy, and without a fundamental commitment to changing the key rules and incentives which impose the greatest costs, it will be enormously difficult, if not impossible, to solve South Africa's housing problems.

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<sup>1/</sup> The views expressed in this paper are solely those of the author.

<sup>2/</sup> See Mayo (1993).

Devising a strategy for dealing with the problems in the sector is analogous to the problem confronted by a medical doctor, who must first evaluate the health of a patient on the basis of his symptoms, and must then determine whether to treat the symptoms or the underlying causes of the problem. In the South African context, the key problem confronting the housing sector is the spatial segregation of different racial groups within cities, and the set of rules, institutions, and regulations that have existed to establish and maintain this segregation. Aggravating this problem is a severely circumscribed set of property rights for the majority of society, a public sector which has responded inadequately to fulfilling basic needs for residential services such as pure water and decent sanitation, and a housing delivery system with limited capacity for responding to the needs of the majority of the population. As will be discussed below, these are the fundamental issues of reform confronting the sector. Other apparent problems in the sector, such as the existence of a so-called "housing backlog" are seen as symptomatic of the underlying problems in the sector, and, as such, should probably not be seen as the primary focal point of reform efforts. The following section provides a measure of detail on a number of dimensions of these current problems.

The performance of the South African housing sector in international perspective: Data from the Housing Indicators Program have been collected in 53 cities in as many countries around the world. The data cover key aspects of the performance of the housing sector from the standpoint of five key "stakeholders" in the housing sector: end users, producers, financiers, and local and national governments. In addition to collecting information on key housing sector outcomes, the Program also collects data on the differences from place to place in policies, regulations, and institutions that might be associated with key differences in housing sector outcomes. The data can be examined in much the way that a physician would examine a patient -- checking to see whether or not particular sectoral outcomes are "normal" and, if not, checking to see whether the cause of the abnormality (e.g., in the case of housing, policies, regulations, or institutions) is evident. In this way, a diagnosis may be made of the cause of the problem, and, at least in a tentative way, a prescriptive regimen described.

While as yet this procedure is still in an early stage of development, it is nevertheless instructive to examine the performance of the South African housing sector in light of international experience. Table 1 presents a number of key indicators of housing sector performance for South Africa and eight other countries with relatively similar GNP per capita, ranging from Jordan (\$1240 in 1990) to Korea (\$5400 in 1990). All figures are for 1990; they should be interpreted with caution as data are still in the process of being verified. Among the key observations from the table are the following:

Housing Quality and commuting: Based on data from the PWV area, South Africa ranks poorly on a number of measures of housing quality among countries with relatively similar income. South Africa is last among nine countries in terms of the proportion of housing units built of permanent building materials (66.2%). Only about 34% (300,000 of 850,000 units) in the informal housing stock, however, appears to be built of permanent materials. While it is estimated that some 95% of housing units in the PWV Region have at least plot access to water, some 42% of the housing stock is estimated to have no direct house connection to a source of potable water. Nearly 34% of housing in the PWV area is estimated to be unauthorized. Only Turkey, with considerably less per capita income, has a higher proportion of unauthorized housing. Commuting times for the journey to work in South Africa are considerably above average among the reporting countries, with black households confronting an average worktrip of about an hour each way.

Table 1

## Indicators of Housing Sector Performance

Housing Outcome	Jordan	Thailand	Tunisia	Turkey	Algeria	Malaysia	South Africa	Brazil	Korea
Floor area/ person (m2)	10.0	16.5	6.5	17.0	8.5	18.6	11.1	19.4	13.0
Unauthor- ized housing (%)	14.9	17.2	29.1	51.0	4.4	12.4	33.8	19.4	6.4
Permanent structures, %	96.5	96.5	95.7	95.0	96.8	86.4	66.2	99.0	97.1
Water connection (%)	97.0	78.7	86.4	94.0	94.5	94.0	95.0	97.0	99.6
Journey to work (mins)	30.0	51	37.0	40.0	30.0	33.5	59.0	107.0	37.0
Housing Invest- ment/ GCP <sup>***</sup>	10.0	8.1	7.0	7.7	8.6	5.2	0.9	8.1	4.5
Housing credit/ all credit	0.190	7.1	0.084	0.003	0.000	22.0	0.390	0.326	0.052
Infrastr. investment/ popn,\$	458	101	86	n.a.	13	81	62	223	455
Rent/ income	16.3*	20.0	20.6	25.0	5.8*	26.2	5.3*	14.4*	35.2
GNP per capita (\$US)	1240	1420	1440	1630	2060	2320	2530	2680	5400

Notes: Source: unpublished data from the Housing Indicators Program, World Bank, 1991. Data are for the following cities: Bangkok, Tunis, Istanbul, Amman, Kuala Lumpur, Rio de Janeiro, and Johannesburg (Pretoria-Witwaterstrand-Vereeniging). A single asterisk indicates the presence of rent control existing among different population subgroups. GCP is estimated Gross City Product, a city level version of Gross National Product.

The median amount of floor area per person in the PWV area is low relative to the level of resources of the population -- some 11 square meters. This figure, however, hides the wide discrepancies among different groups in the area. Approximate amounts of residential living space per person occupied by different racial groups in the PWV area in 1989 were estimated to be as follows:

<u>Racial group</u>	<u>Floor area (M2) per person</u>
Whites	33.2
Colored	12.0
Asian	18.2
Black (formal hsg)	8.9
Black (backyard shacks)	4.8
Black (squatter settlements)	4.2

In most countries, discrepancies between high and low income groups in terms of living space are less extreme (in relative terms, it is more differences in housing quality than space that distinguishes income groups). Based on internationally observed patterns, it might have been expected that low-income black households would be occupying roughly twice as much space per person were markets not so distorted.

Rents relative to income: Rents relative to incomes in South Africa are lower than corresponding figures in all of the countries reporting. Only in Algeria, where rents are strictly controlled, are rents nearly as low relative to incomes. Rents, however, are very different for black and white households; blacks typically spend considerably less than 10 percent of their incomes for housing compared to 20-22 percent for whites. South Africa is one of the few countries in the world where the low-income population is observed to be spending a lower proportion of income on rent than is the case for the higher-income population. This comparatively depressed level of spending among blacks is the result of a number of features of apartheid, which controlled rents, forbade private ownership among blacks, failed to provide secure tenure, and located black townships in areas where transportation and other costs of daily existence were made so high that spending for housing was effectively crowded out of family budgets. Low rents, and low willingness to pay for housing, are major determinants of poor housing quality outcomes and are contributing factors to the comparatively low ratio of housing investment to GNP. When willingness to spend for housing is high, unit values of housing are also high, so that a given volume of housing production is associated with a correspondingly higher volume of investment.

Infrastructure spending: This is a measure of annual per capita spending on the principal types of residential infrastructure (roads, sewerage, drainage, water supply, electricity, and garbage collection) within urban areas. Because of difficulties in measurement, this measure should be viewed with caution. For the entire population, the reported figure is modest by international standards -- \$62 annually, which is comparable to figures for Thailand and Tunisia despite the lower income levels of these countries. As in the case of other overall statistics, however, the average conceals wide discrepancies among blacks and whites. For example, infrastructure spending per capita in white areas in the PWV was reported to be R1417 or \$552 in 1990, higher than reported figures for any of the 35 developing countries included in the Housing Indicators Program and, indeed, higher than reported figures for Stockholm, Sweden (\$223), Munich, Germany (\$267), Hong Kong (\$304), Melbourne, Australia (\$335), and Singapore (\$338).

Housing credit and total credit: This is a measure of the importance of formal mortgage credit in the portfolios of the consolidated banking system. South Africa has an unusually high proportion of the assets of its banking system allocated to residential mortgages, 39%, a figure much higher than that of every country in the developing world for which data have been recorded, and surpassed among reporting developed countries only by the United States (43.6%). Of the roughly R52 billion in outstanding mortgages in South Africa in the early 1990s, however, only some R6-8 billion was allocated to mortgages in the black townships. Annual new mortgage originations in South Africa are between R8-9 billion, with net changes in outstanding mortgage credit of R3-4 billion. These figures may be compared to annual housing investment of R6-7 billion, indicating that a high proportion of the value of new housing construction is formally financed. On the other hand about 80% of the newly built housing in the PWV is unauthorized, and effectively none of it is formally financed.

Housing Investment: Housing investment as a percentage of Gross City Product is lower in the PWV area than in any of the cities included in the table -- 0.9%. Rio de Janeiro, Brazil, with a similar level of GCP per capita is investing about 8.1% of GCP in housing. Cities in other countries appear to be investing as much as 10% of their annual income in housing in 1990. These figures may vary considerably from year to year, so some caution is needed in their interpretation. At the national level, the figure for South Africa is correspondingly low -- 2.6% in 1990. Further, it is useful to note that the highest level attained by South African housing investment since 1983 was only 3.4% of GNP in 1984.

A Statistical summary: Based on previously unpublished statistical comparisons among countries included in the Housing Indicators Program, the performance of the South African housing sector can truly be said to be a story of black and white contrasts. Multivariate analyses of key housing sector outcomes in South Africa have attempted to estimate the degree to which various outcomes either exceed or fall short of expectations. Quantitative estimates of discrepancies from expectations for key variables are given in Table 2. For its level of GNP per capita, housing conditions are worse overall than should be expected, and worse yet for the black population. Housing investment is low relative to GNP, in part because effective demand is low. Effective demand is low in the white community because of comparatively static incomes and static population. Effective demand is low for the black population because of the effects of a variety of apartheid policies that have squeezed household budgets and quashed incentives to spend voluntarily on housing improvements. Thus the housing sector is not serving well the interests of either the black population or the economy as a whole.

Against these impressions of an underperforming housing sector are other impressions of considerable resources which, if reallocated toward the black community, could do much to improve its housing and at the same time contribute toward economic growth. Specifically, the level of outstanding mortgage credit, and the annual new volume of credit created, are striking for a country at South Africa's level of economic development. Only modest reallocation of mortgage portfolios toward the black community could begin to have an immediate and substantial impact on their housing conditions. At the same time, some of the considerable resources now being spent on residential infrastructure within white areas could be diverted to servicing black areas, with favorable impacts in terms not only of improvements in service quality but also on incentives for residents of those areas to undertake complementary improvements in their dwellings.

Formulating a comprehensive approach to policy reform, however, depends on a careful appraisal of different elements of possible housing strategies, and of the degree to which each can contribute toward addressing the problems at hand. The next section discusses the approach toward housing policy formulation that has been adopted both by the United Nations and by the World Bank -- the concept of an "enabling strategy" for the housing sector.

Table 2

**Estimated discrepancies from expected international values of key housing parameters**

<b>Housing outcome</b>	<b>"Expected" outcome</b>	<b>Actual outcome</b>	<b>Discrepancy</b>
Floor area per person (m <sup>2</sup> )	18.5	11.1	- 40 %
Permanent structures (%)	89.5	66.2	- 26 %
Unauthorized housing (%)	16.3	33.8	107 %
Journey to work (minutes)	40	59	48 %
Rent-to-income ratio (%)	21.2	5.3	- 75 %
Housing credit/all credit (%)	14.1	39.0	176 %
Housing investment/GCP (%)	5.8	0.9	- 84 %

Source: unpublished multivariate statistical analyses from the Housing Indicators Program. Expected outcomes are based on regression equations expressing given outcomes in terms of household incomes, household size, city size, etc.

## A Framework for Policy Reform

In formulating housing policy and a strategy for its implementation, the setting of appropriate goals is essential. It is critical that goals be formulated with reference to the objectives of all of the key participants in the housing sector -- consumers, producers, financiers, and both local and central governments.<sup>3/</sup> Unless the housing sector is treated as a complex and interrelated system, policy reform is likely to lead to less equitable, less efficient, and less easily sustained changes in the housing delivery system than are desirable.

And within the South African context, it is critical to recognize the importance of dealing as directly and forcefully as possible to remove the vestiges of apartheid as it has influenced the performance of the housing sector, so as to bring about the goal of a well-functioning, non-racial society and economy. This will involve more than just changing the overt mechanisms of apartheid and then "letting the market work". It requires an active role for government to help markets to work in the interests of all citizens and when, as is likely to be the case for some time, markets are unable to provide for the needs and best interests of the most disadvantaged, it requires active intervention in the form of well-designed systems of transfers.

An appropriate overall framework for housing policy in South Africa could be the "enabling framework" suggested in the *Global Shelter Strategy for the Year 2000* which was endorsed by the United Nations General Assembly in 1988, and which is expanded upon in a recent World Bank policy paper entitled *Housing: Enabling Markets to Work*. Within such a framework, the role of government is an important one, though one primarily of enabling and facilitating the activities of the private sector -- individuals, businesses, and community based organizations -- to provide and maintain housing. In South Africa, the key elements of such an approach involve action on three broad fronts: (1) stimulating the demand for housing, (2) facilitating housing supply, and (3) creating an appropriate institutional framework for the management of the housing sector.

Stimulating the demand for housing: Problems with poor quality housing among the black population in South Africa are the product of both insufficient demand and an inadequate housing delivery system. While low incomes play a major role in observed housing deficiencies, spending patterns have been distorted and depressed by a number of different apartheid-related policies. As a result, policies in support of economic growth which encourage more rapid growth in the incomes and employment prospects of black South Africans will be an important, though less than fully effective, means for improving housing conditions. Policies to (1) increase the availability of housing finance, (2) improve security of tenure, and (3) provide housing subsidies are essential complements to overall development policies.

Moreover, policies to stimulate the demand for housing must be formulated with the clear understanding that housing is more than simply four walls and a roof.<sup>4/</sup> Housing is a complicated bundle of attributes, some of which will have considerably greater value than others to its occupants. In particular, the location of housing will likely have as much or more importance to many households than its actual physical condition. Being close to places of employment enables household members to find and hold jobs, to reduce their spending on wasteful commuting trips, and probably to reduce costs of purchasing goods other than

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<sup>3/</sup> Some of the objectives of each of these actors are set out in Annex 1 to this paper

<sup>4/</sup> In practice, this suggests that however useful it may seem to describe housing demand in terms of "backlogs" of unacceptable housing units against a reference of high-standard, formally built dwellings, to use such figures as the basis for establishing numerical targets for housing policy can be extremely misleading. Defining shortfalls in terms of inadequate basic services, insecure tenure, and a limited range of spatial choice is likely to come closer to addressing the most pressing housing needs of the majority of South Africans at the present time.

housing as well. In addition, having secure and transferable property rights to housing creates a value that is entirely independent of its physical properties. The collateral value of housing can be tapped by households for a variety of purposes, including startup capital for small businesses or the education of children, at borrowing costs that are well below the costs of informal borrowing or unsecured lending. In addition, the prospective degree of choice that households have about the range of products, types of tenure, and locations will have an important bearing on the satisfaction to be derived from whatever the final choice of housing. Finally, physical attributes, such as the amount of living space and the durability of the structure do matter to households, though often to a lesser degree than might be imagined by the usual designers of housing policies.

Policies to stimulate the demand for those attributes of housing that are most valued by households in terms of their own priorities are the most appropriate. Within the past, and because of explicit government policies, black households have not had the ability to exercise freely choices over location, they have been unable to acquire secure tenure, and their choice of physical housing options has been severely circumscribed. Consequently they have been both unwilling and unable to spend more for housing. If policies are put in place to open up a wide range of options concerning these features of housing, it is to be expected that many, if not most, black households would over time choose voluntarily to increase their spending for housing, adding an important and necessary infusion of resources into the housing sector. To the degree that policies regarding housing finance, the provision of secure tenure, and housing subsidies can augment and stimulate that natural tendency, purely public resources can be leveraged several-fold to increase the demand for housing and, presuming that the housing delivery system is also improved, this can result in rapidly improved housing conditions.

Changing the effective demand of households for housing is a necessary prerequisite for increasing resource flows into the sector on a permanent and sustained basis. This means increasing contributions of households, financial institutions, and, at least temporarily, government. Without taking account of the structure of incentives and the motivations of individuals and institutions, additional resources from one source may simply replace resources from other sources, with little or no net increase in total resources available.<sup>5/</sup> Thus, a principal challenge of housing policy is to put in place a set of policies that gets the greatest possible "housing impact" for the least total expenditure of resources. This will also ensure that for a fixed subsidy budget, resources can be more widely spread, or administered sooner on behalf of intended beneficiaries.

Increasing the availability of housing finance: Housing finance in South Africa, as noted above, is both broad and deep for the white community, and plays an important role in the financial sector. Nearly forty percent of the consolidated assets of the banking system are in the form of residential mortgages, a level higher than that of any developing country for which data have been so far collected as part of a World Bank study of housing sector performance. Of that, only 12 to 15 percent goes to borrowers in the black townships. Clearly it is essential to increase the access of the black community to formal finance, if housing conditions are to be improved.

At the present time, and despite a generally favorable lending experience with borrowers in black townships, financial institutions are reluctant to extend loans to housing purchasers in black townships because of a fear of losses associated with either potential mortgage bond boycotts or the inability to recover property

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<sup>5/</sup>In the United States, for example, it has been found that increased production of new publicly subsidized housing is largely offset by decreases in the level of new private housing construction, leading to little net increase in the overall stock of housing. In a number of centrally planned economies massive state subsidization of housing has been more than offset by the dampening of private spending for housing with the result that overall levels of housing investment in those economies have been lower than levels in similar market-oriented economies, and both the physical quality of housing, crowding, and freedom of choice have suffered.



under foreclosure in the event of mortgage defaults. These possibilities put at risk the entire mortgage loan amount of lending institutions so, as a result, even the existence of a Mortgage Loan Guarantee Fund, which can ensure 30 percent of potential loan losses, is ineffectual in inducing banks to lend for housing. While talk is also heard among the financial community about the additional administrative cost of making smaller loans which typify black borrowers, neither the loan default experience of most South African institutions nor international experience of other financial institutions lending to low income populations supports this as a serious argument.<sup>6/</sup> If banks are voluntarily to resume lending, these sorts of risks must be mitigated through agreements between lending institutions and community members of the townships, the form of which might involve considerably greater community presence and provision of collateral services to borrowers than is now the case, in exchange for banks being able to enforce provisions of lending agreements.<sup>7/</sup>

Until such time as financial institutions can be assured that their voluntary participation in "downmarket" lending will be profitable, as a result of better collateral security, it makes little sense to think of so-called "prescribed investments" in housing. Forcing banks to make unprofitable investments is not an enabling strategy, but rather one that is likely to disable the ability of the banking system to expand voluntarily into lending for low-income housing. Moreover it is likely to be unnecessary. Other countries, such as Thailand and Colombia, which have had rapidly expanding housing finance volumes reaching well downmarket have been able to achieve these results without recourse to directed credit schemes. Malaysia, which since 1973 has had a nominal directed credit provision relating to low-income housing (and rapidly expanding housing finance availability), wrote the provision in such a way that by 1974 the banking system was already in compliance. As such the nominal "constraint" on banks' lending activities has not been close to being binding for nearly 20 years; once banks found it profitable to lend for housing, residential mortgages became the most rapidly expanding part of their lending portfolios, with compound rates of growth of over 30 percent per year for well over a decade.

This is not to say that more can should not be done to facilitate an expansion of credit for lower-income households. There are a number of actions that could be taken to facilitate flows of credit to such households. Aside from actions to improve perceived collateral security, consideration might be given to establishing well-publicized voluntary lending targets for low-income mortgage lending. It might also be possible to increase collateral security by seeking third party guarantors for low-income lenders and by making greater use of "source-withholding" of mortgage payments by employers. These latter two strategies have been particularly effective in India, where the Housing Development Finance Corporation in Bombay has become a highly profitable private banking institution with defaults on mortgages at a rate less than one-tenth of one percent.

Other actions that could help to expand credit by banking institutions include innovative mortgage instrument design such as graduated payment mortgages or so-called dual-index mortgages each of which can offer borrowers significant advantages which have the effect of lowering default risk in the critical early years of mortgage repayment. In addition, expanded unsecured lending with group guarantees can be done for shorter-term loans for housing purchase or upgrading of existing housing. The best example of this sort of lending is that of the Group Credit Company. Activities of the IDT Finance Corporation represent a similar

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<sup>6/</sup> For example, the proportion of loans by the Perm to borrowers in black townships which were three months or more in arrears as of November, 1991 were lower than the reported mortgage arrears rate in either Thai or Malaysian banks, where profitability is considerable, operating margins are comparable to those of South African institutions, and mortgage loan portfolios of the banking system as a whole have been growing at a rate of more than 30% per year for more than a decade.

<sup>7/</sup> Both the Perm and the South African Housing Trust appear to have been more responsive than most other mortgage granting institutions to interacting on the ground with black township borrowers, providing a variety of counseling services and a more visible community presence.

approach, and are to be encouraged. Expansion of such types of lending on a larger scale will require the development of a broader network of community-based financial institutions, the capitalization of which and technical support for which should be encouraged on the part of commercial lending institutions. The potential capacity and operating characteristics of such institutions appear to be unknown at present, and should be systematically examined.

Pension funds and life insurance companies can also play a greater role than they now do in making resources available for low-income housing. This might take the form of (1) greater use of secured lending against life insurance or pension equity values to policyholders or (2) holding of securitized mortgages where the underlying mortgages have been originated by commercial banks or other financial institutions. If mortgages to be securitized were based on indexed loans such as dual-index mortgages, repayments on which are linked to wage or salary indexes, pension funds, whose liabilities are also wage and salary-linked, might find such securities to be an attractive portfolio instrument. It would be possible, in principle, to also securitize packages of loans made by group credit institutions such as the GCC or the IDTFC, enabling the latter to increase liquidity and permitting attractive yields to pension or life insurance firms.

Improving security of tenure: Within the PWV area, squatter housing comprises some 23% of the current housing stock. Moreover, this figure is growing rapidly. About 80% of new housing being built in the area is unauthorized -- in the form of squatter housing, backyard shacks, and garages or other outbuildings used as shelter. In addition to such technically illegal housing, much of the formal housing in black townships is of ambiguous tenure, little of a clear freehold nature.

Lack of security of tenure is one of the greatest known impediments to voluntary resource mobilization for housing. When households have little assurance that they will in the future be able to enjoy the benefits of their housing investments, they will be unwilling to invest. Experience around the world has shown that when illegal tenure is regularized, households frequently mobilize remarkable amounts of resources to consolidate and upgrade their dwellings and neighborhood facilities. In many places this is the product of both informal resource mobilization and formal borrowing.

Programs to upgrade tenure, to clarify tenure, and to make secure tenure an option for new entrants to the urban area should be an important part of any overall strategy to stimulate the demand for housing. In many cases, the benefits of tenure security can be observed as a result of simply providing services to squatter areas. It is preferable, however, to undertake programs which make available full legally-enforceable tenure.

Privatization of publicly-owned stocks of housing is also a form of tenure regularization. The remaining stock of government-owned rental dwellings in the black townships should probably all be transferred to existing tenants (some of whom have already in effect paid off the equivalent of a mortgage) at nominal or zero cost. The advantages of increased security of tenure are likely to far outweigh any fiscal penalty associated with sales at less than market value. In addition, concerns with current inequities in awarding what amounts to significant "lottery winnings" to a substantial part of the population without regard to objective measures of "need" should not be seen as a major objection to rapid transfer of assets.

Provision of subsidies: Because the legacy of apartheid is reflected in poor quality housing and depressed demand, well-conceived subsidy policies should be seen as an essential component of overall housing policy. In designing subsidies for housing, a number of general principles are commonly applied. Among these are that they should be equitable and well-targeted, measurable and transparent, non-distorting, and administratively simple. In addition, subsidies should, to the extent possible, be able to allow households the widest possible latitude in choice of acceptable housing solutions. Principles of equity are often defined in

terms of "vertical equity" and "horizontal equity". Vertical equity means that subsidies are progressive -- that those least able to provide for themselves or most in need receive higher subsidies, or get subsidies sooner than those less in need. Horizontal equity means that similar households are treated equally -- suggesting, for example, that real benefits should be similar in different locations and that it is inherently unfair if equally deserving potential beneficiaries are required to wait for very different time periods before receiving a subsidy. When subsidies are measurable and transparent, on-the-books rather than off them (as in the case of many interest subsidies), it is easier to control their size and to ensure that targeting is efficient and equitable. Subsidies should also be designed in a way that their effect is not to unnecessarily raise costs for other groups in society. Subsidies can, however, be designed so as to encourage certain types of behavior on the part of recipients, such as increasing their own savings toward housing or choosing to live in housing with certain characteristics.

In practice, there is no ideal subsidy system, since many of the criteria just enumerated may conflict with each other, and because the behavioral response of households and institutions will vary from place to place depending on economics and culture. For example, targeting is improved at the cost of greater administrative complexity. Vertical equity may be sacrificed at the cost of encouraging participation among households willing to voluntarily match subsidies with their own resources.

Within the South African context, thinking about subsidies is already quite sophisticated. Programs such as the IDT capital subsidy represent, in principle, a far more appropriate approach to housing subsidies than what is found in most developing countries. If this scheme is subjected to the criteria described above, however, it could possibly be improved upon.

For example, suppose that the goal of subsidies is seen to be that of stimulating demand for housing so as to enable the largest possible number of disadvantaged households to gain rapid access to improved housing conditions. In this case, one might consider a subsidy entitlement of either a smaller amount, or even a larger amount payable over an extended period of time, which, for a given subsidy budget, could reach a greater number of households in a shorter period of time. Suppose also that a goal of the subsidy system is to encourage universal access to basic services, tenure security, and a wide spatial latitude in choice, as well as access to improved physical housing conditions. In this case, a more flexible subsidy, which could be applied to either new or existing housing and either rental or owner-occupied housing might be considered.

Such a subsidy could be designed as a housing allowance in the form of a "housing account" which could be drawn on for approved purposes such as the purchase of a serviced stand, rental of a structure meeting minimal standards of services, or upgrading of substandard housing. Such an account could be interest bearing, such that households could choose to draw on only the interest during a particular year, retaining the principal for later use. If, for example, an account of R7500 were established with an interest rate of 15% per year, the interest alone would amount to R1125, an amount that is more than twice the prevailing rent level in many areas of informal housing. Were households to continue spending, say, R500 per year of their own resources for rental accommodation after receipt of such a rental allowance, this would effectively triple their housing demand, enabling them to rent more space, in a better location, at higher quality, or with better residential services. If the household chose instead to purchase a serviced stand it would be free to do so. While such a scheme would certainly be administratively more complex than a simple capital subsidy, it would offer a number of advantages. It would reach more people in a shorter period of time, and it would allow households themselves to determine the kind of housing and location that they would prefer. With only modest earmarking, in terms of the types of "qualifying uses", significant incentives could be created for both households and informal suppliers to upgrade their quality of housing.

not clear?

who make initial contact with?

It should be noted that such a scheme, while potentially made universally available to any defined eligible population, would be characterized by a less than universal take-up rate because of both the time that it takes for households to satisfy the earmarking requirements of the subsidy and because many households might choose voluntarily to allow the principal in their housing account to accumulate until better housing solutions are available to them. In addition, the scheme could be made available first to only parts of the potentially eligible population, with eligibility extended over time as funds permit. Key decisions concerning the time-phasing of this or any other subsidy scheme must be informed by a realistic assessment of the current and projected "fiscal envelope" for not only housing subsidies but of other social development programs as well.

While subsidy schemes based on stimulating the demand for housing by putting choices in the hands of consumers have much to commend them, it is clear that a great deal needs to be done to ensure that the housing delivery system, both in terms of residential services such as water, electricity, and sanitation, and in terms of houses, is responsive to these shifts in demand.

Facilitating housing supply: Just as housing demand must be seen in terms of the complex bundle of attributes involving location, infrastructure, tenure security, and housing itself, so too must housing supply be seen in these terms. In addition, the process of housing supply necessitates a concern with the supply of housing inputs such as labor, building materials, and entrepreneurship.

If increases in resources provided to the housing sector as a result of stimulating demand are to be effectively translated into increases in housing output, improved housing quality, and increases in the employment and earnings associated with greater construction activity, the housing sector must be responsive to shifts in demand. If, for whatever reason, supply rigidities exist, shifts in demand will be translated as much (or more) into price increases as into houses, jobs, and income.

Experience around the world is quite sobering about the importance of ensuring a flexible supply system. In countries with relatively modest government interference in the housing supply system and with freely competitive markets for housing inputs and outputs (countries such as Colombia and Thailand in the developing world and Australia and the United States among developed countries), estimated "housing supply elasticities" which measure the responsiveness of housing supply to shifts in demand are quite high, with relatively modest demand shifts quickly translated into increases in housing production. In such countries housing prices are low relative to incomes, with typical housing units in most urban areas costing from 2.5 to 3.5 times typical household incomes. In countries with significant government intervention in the form of stringent land use and building controls, inviolable agricultural greenbelts, or monopoly elements in the areas of building materials, land development, or land ownership, housing supply is unresponsive to demand shifts and, as a result, demand shifts are readily translated into rapidly escalating housing prices. Studies have indicated that, largely because of regulatory differences, housing supply in Thailand is, for, example, some 30 times as responsive to demand shifts as is supply in either Malaysia or Korea. Typical urban housing prices in Korea (Seoul) and Malaysia (Kuala Lumpur) are equal to about 6 and 11 times household incomes respectively compared to a multiple of about 3 in Thailand (Bangkok).

Ensuring a flexible supply system is therefore of paramount importance if the housing sector is to function properly. Policies in three broad areas are appropriate: (1) ensuring adequate infrastructure supply, (2) rationalizing the legal and regulatory framework for land and housing, and (3) ensuring that the building construction industry is competitive and responsive.

Ensuring adequate infrastructure supply: Infrastructure supply, involving electricity, water, sanitation, drainage, and transport facilities is important not only in its own right, in terms of the services that it provides

to households, but because it is an essential complement to housing superstructure. Without infrastructure, households are simply less willing to invest in houses. This is, in general, even truer of rental housing investment than of owner-occupied housing because the greater density typically associated with rental housing usually requires a higher level of infrastructure servicing. (It may be noted that in most developing country cities, renters have higher levels of access to residential services than do owners, often because they are closer to city centers where infrastructure networks are better developed.)

In addition, when infrastructure is in short supply serviced land will command a premium over the cost of unserviced land that is greater than the actual cost of servicing. This can be passed through in the form of higher housing prices.

Infrastructure deficiencies in South African cities have been documented extensively, so there will be no further elaboration here. It is apparent, however that existing levels of service deficiencies are unacceptable, and must be addressed in a concerted way if basic needs are to be met and if infrastructure availability is to facilitate the process of housing supply. Experience in other countries has repeatedly indicated that provision of infrastructure through large-scale land development, slum upgrading, and modest "sites-and-services" projects is effective in satisfying the most pressing needs of the largest fraction of the low-income population, and carries economic rates of return far higher than those of publicly-supported projects which provide completed (and often heavily subsidized) housing units.

Rationalizing the legal and regulatory framework: As described above, the legal and regulatory framework for land use and building can have major impacts on the responsiveness of the housing supply system and on the price of housing. Data collected as part of the Housing Indicators Program have indicated that the regulatory process appears to be unduly cumbersome, with for example, delays of two or more years to obtain planning permission for new townships not uncommon. In addition, it appears that infrastructure standards for new developments are sometimes higher than is necessary, with the effect that land and hence housing costs are higher than necessary -- especially for low-income housing. Thus, to ensure a responsive supply of serviced land, it is necessary to review and revise planning regulations both with regard to their stringency and their procedural complexities.

In addition, consideration should be given to the possible use of fiscal mechanisms to increase land supply. At present vacant land within urban areas is often taxed at rates inconsistent with the potential use value of the land. Consideration should be given to changing property tax assessment procedures to create an incentive for such land to be brought to market.

Ensuring that the building industry is competitive and responsive: A principal condition for ensuring that housing supply is responsive to demand shifts is that the input and output (completed housing) markets be competitive. If market power is concentrated in the hands of a small number of actors, then conditions will not be competitive and demand shifts are likely to be reflected not in increased housing output but rather in terms of higher prices and higher profits.

In many countries, market concentration is the product of tedious, complicated, and capricious regulatory processes for land development and construction. Because only relatively well-capitalized firms will have the capacity to traverse difficult and time-consuming regulatory mazes, land development and housing production may be concentrated in the hands of a small number of firms. In Bangkok, with a simple regulatory framework where most approvals can be obtained in 3-6 months, only 9 percent of all new formal housing is produced by the five largest developers. In Kuala Lumpur, where typical approval times for many residential subdivisions have been as long as 5 to 7 years, more than 70 percent of the housing is built by the 5 largest

developers. In the PWV area, it appears that in the early 1990s some 85% of new formal housing construction was being done by the five largest developers. Whether this is the product of the regulatory structure of the market or other factors is not known. Whatever the reason for this degree of concentration, however, it suggests that the capacity of the land development and housing construction industry is unusually concentrated and may be both limited in capacity and somewhat unresponsive to demand shifts.

At the same time, it appears that market power is heavily concentrated among the producers and distributors of building materials. For most major building materials, no more than two firms appear to control the overwhelming proportion of activity. Unpublished studies have documented the classical price-setting behavior of building material cartels in South Africa, and give serious cause for concern about the likely responsiveness of the South African residential construction industry.

Such concerns are further heightened by an examination of the movements of both housing prices and building costs during periods of rapid upward shifts in demand in South Africa. During the boom years of the early 1980s, both housing prices and building materials prices increased far more rapidly than either income or consumer price indices, suggesting that neither input nor output markets are particularly competitive. Within recent years, it is difficult to find direct evidence of this because demand in the formal sector of the market has been largely quiescent, the product of no growth in real incomes and relatively static population. Existing degrees of market concentration and evidence of past unresponsiveness of building materials and housing supply, however, suggest that without some explicit action to increase the degree of competition in both input and output markets, any major infusions of resources on the demand side of the housing market could be dissipated to a considerable degree in price rather than output changes. This might involve taking action to break up existing monopoly or cartel elements, particularly within the building materials industry. In addition, options should be explored to increase the capacity and ability to respond of small-scale black developers and contractors.

Providing an appropriate institutional framework: The recent institutional framework for the formulation and implementation of housing policy in South Africa has not served the interests of either individual citizens or of the economy as a whole. On the other hand, recent developments, and particularly the emergence of a vigorous Housing Forum representing the interests of a wide range of housing sector stakeholders, have given cause for considerable optimism concerning the likely future structure of national and local institutions charged with the formulation and implementation of housing policy.

It is to be hoped that the idea of a single housing ministry charged with overall responsibility for policy formulation, coordination, and monitoring of sectoral performance has found sufficient acceptance to lead to concrete action. In considering other aspects of institutional structure, organizational arrangements should be determined largely by the distinct functions that might be identified within the housing sector, which are in turn determined by the elements of the strategic framework presented above.

Such an agency should have a broad, sector-wide approach in its objectives and activities. It should oversee the performance of the sector as a whole, bringing together all the major public agencies which influence housing sector performance through their policies and actions. It should collect, analyze, interpret and publish data on the performance of the housing sector as a whole on a regular basis; provide an institutional linkage between housing and macro-economic planning; generate long-term plans (e.g. five year plans) for housing sector development in conjunction with the central planning agency; provide a forum for participation of the private sector, the NGO's and the general public in housing policy formulation; review the effects of the regulatory environment on the quality, quantity and price of housing and to initiate regulatory reforms; engage in housing policy research; and influence the decision makers in housing-related agencies to act in a manner

which improves housing sector performance. Examples of such an institution already exist in Thailand and Jamaica.

Taking on the responsibility for the performance of the housing sector as a whole will also involve measuring and accounting for housing demand and housing supply. This in turn will involve evaluating the availability of credit and subsidies, the adequacy of residential land and infrastructure facilities, the efficiency of the building industry, and the effectiveness of the regulatory environment of the housing sector.

In addition to the functions to be performed by a central agency several other functions need to be addressed, each of which could be performed either by a specialized agency or, in some cases, combined into a single institution. These include: (1) establishing and overseeing the regulatory environment for the delivery of housing finance by the private sector, for developing effective instruments for directing mortgage lending to the poor, and for providing an institutional linkage between housing finance and the Ministry of Finance and the Central Bank; (2) administering housing subsidies to the needy, preferably focusing on beneficiaries rather than on dwelling units; (3) improving security of tenure both by privatizing government-owned housing and regularizing tenure in squatter settlements; (4) providing infrastructure in slums and squatter settlements; (5) bringing together infrastructure agencies to coordinate infrastructure provision in a manner which ensures an adequate supply of developed land; and (6) overseeing and regulating firms involved in the production of building materials and housing so as to ensure competition.

Within the current South African context, many of the most pressing issues of establishing an appropriate institutional framework have to do with the allocation of responsibility between the central government and future, as yet unformed, local governments. Alternative arrangements need to be carefully explored in order to ensure that the institutional structure is capable of ensuring that the goal of a well-functioning housing sector, one capable of meeting the needs of all citizens and one capable of serving broad development objectives, is met.

### **The Role of International Institutions**

The task of creating effective enabling strategies for housing and, particularly, for housing finance is one that requires the creative energies of all levels of government and of associations of the many stakeholders in the housing sector. International organizations such as the bilateral donors, the Regional Development Banks, the United Nations Centre for Human Settlements, and the World Bank can and will support local and national reform efforts through programs of grants, loans, and technical assistance. Indeed, compared to earlier periods, when the policy objectives and programs of these many organizations were often at cross purposes, the emerging consensus concerning the need for enabling strategies and the framework for their implementation that has been provided by the Global Shelter Strategy has created a more favorable environment for coordinated policy reform efforts than has perhaps ever existed.

Despite this emerging consensus among governments and international organizations, the fundamental task of policy reform nevertheless remains the responsibility of local and national governments. In terms of resources alone, the potential role of international transfers in contributing towards housing policy objectives in developing countries is limited. For example, in recent years, the World Bank's annual lending for housing and related residential infrastructure in cities has been between roughly US\$1 and 2 billion. In comparison, the annual urban housing investment in developing countries is on the order of US\$150 billion, and the aggregate value of the housing stock in developing country cities is on the order of some US\$9 trillion -- roughly twice the gross national product of all developing countries. Even modest decisions made by local and national

governments that affect the rules and incentives which govern the performance of the housing sector, the productivity of housing and infrastructure investments, and the value of the housing stock and the ease with which it can be effectively collateralized and thus recycled for productive purposes will, each year, have a far greater impact on the well-being of housing consumers, producers, financiers, and investors than will all of the lending by international agencies.

For problems of the severity and importance of South Africa's current housing problem to be attacked effectively depends therefore on both adequate resources and adequate ideas, and it is arguably the case that the latter will bear the higher dividend. There is clearly no shortage of either in South Africa at the moment but, to the extent that the international community is called upon to fill in the inevitable gaps which occur from time to time in each, the stage has now been set for a vigorous and hopefully fruitful partnership.



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## Annex 1

### Desired Outcomes for a Well-functioning Housing Sector

To develop a normative view of the housing sector, one must look at how the sector performs from a number of different perspectives. The five most important perspectives are those of housing consumers, housing producers, housing finance institutions, local governments, and central governments.<sup>1/</sup>

Each of these perspectives focuses on different qualitative norms that represent desired outcomes of each of the key actors. Such desired outcomes, while neither universally attainable nor entirely compatible, may be expected to exert an influence both on behavior of the key actors and on the way that they perceive the efficacy and responsiveness of government policies and programs. These desired outcomes are:

(i) **Housing Consumers.** Everyone is housed, with a separate unit for every household. Housing does not take up an undue portion of household income. House prices are not subject to undue variability. Living space is adequate. Structures are safe and provide adequate protection from the elements, fire, and natural disasters. Services and amenities are available and reliable. Location provides good access to employment. Tenure is secure and protected by due process of law. Households may freely choose among different housing options and tenures (owning vs. renting). Finance is available to smooth expense over time and allow households to save and invest. Adequate information is available to ensure efficient choice. Housing consumers are able to participate in policy decisions that affect their housing and neighborhoods.

(ii) **Housing Producers.** Adequate supply of residential land is available at reasonable prices. Infrastructure networks are adequate and do not hold back residential development. Building materials and equipment and sufficient skilled manpower are available at reasonable prices. Entry of new firms into the residential construction sector is not impeded. The residential construction sector is not discriminated against by special tariffs or controls. Adequate financing is available. Housing production and investment can respond to changes in demand without undue delay. Contracts are enforceable. Regulations concerning land development, land use, building, land tenure, taxation, or special programs are well-defined and predictable, and government application of these is efficient, timely, and uniform. Adequate information exists to enable producers to forecast housing demand with reasonable certainty. Rates of return on all types of housing investment, including rental housing, are sufficient to maintain incentives for investment.

(iii) **Housing Finance Institutions.** Housing finance institutions are permitted to compete for deposits on equal terms with other financial institutions; the role of directed credit is minimized. Housing finance institutions are not forced to compete unfairly with subsidized finance. Lending is at positive real interest rates with a sufficient margin to maintain institutional health. There are sufficient deposits of an appropriate term structure for long-term mortgage lending. Mortgage lending instruments are permitted which are in demand by households, and which provide adequate protection for the institution. Systems of property rights, tenure security, and foreclosure are such that the financial interests of lenders can be protected. Appropriate institutions exist that protect financial institutions against undue mortgage lending risk.

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Other actors may be important in different institutional settings. Among the most important of those are non-government and community-based organizations, state-owned enterprises and firms involved in real-estate brokerage. A more detailed breakdown will also need to take into account the different perspectives of specific government agencies, such as the land department or the fire department, and various agents in formal and informal housing delivery system.

(iv) **Local Governments.** Housing and associated infrastructures are of adequate quality to maintain public health, safety standards, and environmental quality. Infrastructure networks and services are extended in a timely fashion to all communities. Communities can participate effectively in decisions affecting their well-being. The location of new communities is in close proximity to existing main networks. Land use is productive and efficient. Sufficient land can be obtained for laying infrastructure networks and providing local amenities and public services. Housing provides a major source of municipal revenues for building and maintaining infrastructure services and neighborhood amenities.

(v) **Central Governments.** Adequate, affordable housing is available to all. Targeted subsidies are available to assist households that cannot afford minimum housing. Housing sector policy is integrated into national social and economic planning. Housing sector performance is monitored regularly. The housing sector contributes toward broad social and economic objectives: (i) alleviating poverty; (ii) controlling inflation; (iii) generating household savings and mobilizing household productive resources; (iv) generating employment and income growth; (v) enabling social and spatial mobility; (vi) increasing productivity; (vii) generating investment growth; (viii) accumulating national wealth; (ix) reducing the balance of payments deficit; (x) reducing the government budget deficit; (xi) developing the financial system; and (xii) protecting the environment.

While the above list may be incomplete, it does provide a broad normative view of a well-functioning housing sector from the perspectives of its key actors. Needless to say, **these perspectives are not necessarily mutually consistent.** What may benefit one may damage another. Rent control, for example, may benefit families already housed, but may prevent further investment in rental housing and discriminate against new residents. Reducing house prices may benefit housing seekers but reduce the asset value of those owning houses. Increasing land supply may be at the expense of environmental amenities. Stronger foreclosure laws may increase mortgage financing for all at the expense of evictions for some. Resolving these incompatible interests is one of the most fundamental tasks of an effective housing policy.

The housing sector cannot attain many of the stated norms without appropriate interventions by public authorities. However, intervention can be a two-edged sword. Appropriate housing policies can help achieve the goals of a well-functioning housing sector. Inappropriate interventions stifle the sector, block supply and frustrate demand, reduce quality and choice, increase costs, and damage the economy as a whole. But without a better positive understanding of the way the housing sector actually works, there will continue to be confusion about which instruments work and which do not, and difficulty in establishing an objective basis for reconciling the interests of different housing sector participants.