URBAN REAL ESTATE RESEARCH UNIT

HOUSING IN CAPE TOWN IN 2018: A DRAFT DISCUSSION DOCUMENT

Housing in Cape Town IN 2018 - A Draft Discussion Document

2018

R. McGaffin

Urban Real Estate Research Unit
University of Cape Town

1. Background

Cape Town has a housing problem, not just an affordable housing problem. At a city-wide level, there are an estimated 1,2 million households. Of these, it is estimated that about 320 000 households are either living in over-crowded or informal conditions. The performance of housing should however be measured on how it contributes to households economically, financially, socially and physically, and how it contributes to society economically and in the creation of sustainable, efficient and viable cities. The housing "solution" therefore is not just a "numbers game". Notwithstanding this, there is clearly a desperate need to deliver more houses at scale in an appropriate manner. To address the backlog in a 10 – 15 year period, approximately 30 000 houses need to be supplied annually. Unfortunately, this is currently not the case, with between 8 – 10 000 formal houses being delivered every year. About half of these are government subsidized houses and the other half delivered by the formal market. This delivery represents 0,8 – 1% of the total households in the city. However, household growth is increasing at between 1,5 – 2% per annum, resulting in an increasing shortfall.

2. What is "Affordable" Housing?

The reasons for this growing shortfall are historical and complex but central to the problem is the issue of affordability. For a new house to be supplied, the price (value) that a household is willing and able to pay must be greater than the cost to build the house. The ability to pay for a house is a function of a household's income, credit worthiness and the value of existing assets they may own. Unfortunately, many households are asset poor for historical reasons, many have high levels of indebtedness and or impaired credit records and generally have low levels of income. Household income is notoriously difficult to ascertain, but various surveys suggest that about 80% of the city's households earn a gross income of less than R20 000 per month. To put this into perspective, a R20 000 per month household can afford a house of about R500 000 or a monthly rental of about R5 000 per month. This is significantly below the average and median house values of approximately R1 250 000 and R775 000 respectively. Rough calculations suggest that between 50 - 60% of the housing stock in the city is valued above R500 000. Similarly, an entry level market delivered house is about R400 000.

The issue of what is defined as "affordable" is therefore important as it is a term that is used vaguely and applied in an ad hoc and varied manner. Based on the above assessment, it could be argued that affordable housing is that which is affordable to those households earning R20 000 or less per month. However, a far more detailed segmentation of households and disaggregation of housing stock is required as a macro review of the statistics can be misleading and has limited value. Very importantly, a geographical analysis is required as work and social opportunities are not evenly spread throughout the city. Therefore, although there appears to be some surplus stock available to the greater than R20 000 per month income segments of the market, a lot of this stock is not available where it is needed (e.g. inner city). As a result, a more sophisticated, spatially-sensitive definition of affordability is needed that takes into account the house prices in the area and the median incomes of the

households needing to locate in these areas. For example, many graduates, public servants and professionals earning R40 000 per month cannot afford to live in the inner city, where many service-related jobs exist. In this case, “affordable housing” could be defined as housing priced below R1,2 – R1,5 million. The implications of not supplying into this market will be discussed later.

3. Public-related Interventions

3.1. Subsidised Housing

Numerous policy interventions have been implemented and suggested to address the housing problem. To begin with about 110 000 new “RDP” houses have impressively been delivered in the city. However, the subsidized housing model is problematic and will not address the housing problem for a number of reasons. Firstly, for equity reasons, the need to achieve economies of scale and keep costs in check, a standardized house is delivered in often poorly-located areas, which means that the needs of many households are not met. Secondly, the state’s institutional structures and supply-chain requirements, undermine its ability to deliver as is evidenced by the inability to meet housing delivery targets year-on-year. Thirdly, the allocation process is fraught with difficulties, “housing list” challenges and conflict. Furthermore, many poor households are not eligible to receive subsidized housing on the basis of income, lack of dependents, nationality and so on. Fourthly, the densities of new subsidized developments are usually too low to accommodate existing populations, resulting in community resistance, dislocation and issues surrounding temporary housing. Fifthly, the sale restrictions and allocation processes embedded in the model, undermines economic and labour mobility, which is highly problematic considering the high unemployment rate in South Africa. Lastly, national fiscal constraints simply mean that the country cannot afford to roll out the model as envisaged.

3.2. Public Rental Stock

In addition, the City owns a significant amount of public rental stock and continues to build such units. However, both capital and operating fiscal constraints, poor rental collection rates and the significant administrative and political challenges associated with managing such stock, undermines this approach to addressing the housing problem.

3.3. Social Housing

To address the gap in rental housing and to assist those lower income households earning above the “RDP” housing income thresholds, “social housing” has been rolled out through various social housing institutions using a combination of subsidies. These institutions have built some excellent stock, played an important role in countering the negative perceptions of “affordable housing” and learnt valuable lessons on how to manage rental housing. However, the financial and institutional design of the social housing model is unviable, which has, and will continue to, undermine its ability to deliver housing at scale. The relatively small

numbers of social housing delivered in the city over the years is evidence of this problem.

3.4. FLISP

More “demand-side” subsidy instruments have been introduced in the form of the Finance Linked Institutional Subsidy Programme (FLISP). However, administrative challenges, the requirement for households to qualify for a mortgage bond in the first place and the sliding scale of the benefits received, has resulted in this instrument having had a very limited impact.

4. Market-related Interventions

4.1. Rent-Control

The inability of the state to address the housing issue has led to an increasing call for a more market-focused approach. There have been increasing calls for the introduction of rent-control to improve the affordability of stock in the market. Whilst the intentions are good, this suggestion is actually very “anti-poor”. As discussed above, there is already a significant shortfall of housing stock across the housing sub-markets. For new stock to be introduced, the value of that stock must be greater than the cost to build it. As value is a function of the rent paid, any cap on rental will reduce the value and in most cases the cost burden will not be overcome and there will be a significant disincentive for developers and landlords to build new, expand and maintain existing stock. Consequently, only the “lucky few” who get access to existing stock will benefit and the vast majority of poorer households will be excluded from the chance to access new and filtered stock.

4.2. Inclusionary Housing

Similarly, initiatives are under-way to introduce “inclusionary housing” policies in the city. Unfortunately, to date, these policies have been poorly thought through. It is important to recognize that many of the costs associated with a development are the same regardless of the market that they are targeted at – the cost of a brick is the same whether it is in a lower or higher priced unit. Therefore, for a development to include lower value units and remain viable, surplus value has to be created elsewhere in the development. This can be achieved in some cases where additional development rights (e.g. floor space) are granted as the development of this additional space will not incur the same fixed costs (e.g. land cost) as the rest of the development. However, under these conditions, a sophisticated approach is needed to be applied on a case by case basis as any surplus value created will vary by project. Therefore, the surplus value first needs to be calculated and then the number of lower value units that can be viably built with this value calculated. The common ratio of “20% inclusionary units” is therefore arbitrary, crude and is unlikely to result in lower value units being developed.

Furthermore, greater attention needs to be given to the definition of the units to be included. Under most circumstances, the demand for significantly lower value units

will generally not work as not enough surplus value is likely to be created by the additional rights to viably cross-subsidise these units. In addition, the value of the higher value units (needed to create the surplus value) may be undermined, reducing the funds available to build the lower value units. Consequently, most inclusionary housing policies have been successful when the value of the inclusionary units have been determined as a certain percentage below the median income or house price in the area.

Further ambiguities need to be removed from current inclusionary housing debate. It is often unclear whether the inclusionary percentage (e.g. 20%) is meant to be applied to the entire development of just the additional floor space granted? The former position will generally be a non-starter as the cost of incorporating so many lower value units is likely to be significantly higher than any additional value gained from the enhanced development rights. Consequently, there will not be any incentive for the developer to apply for such rights and hence no inclusionary units will be built. The latter application is more realistic but is unlikely to result is a significant number of lower-value units being developed. Even if some inclusionary units can viably be delivered, major challenges still exist in terms of determining who receives these units and how these units are kept in a particular value band.

Considering the complexities associated inclusionary housing, one has to ask if it is worth it? Inclusionary housing policies are only really applicable to multi-unit developments. If one considers that between 4 – 5 000 formal market houses are built every year across the entire city and that 50% of those are estimated to be single residential houses, only about 2 500 units (higher density, sectional title) may be "available" for inclusionary housing interventions. Then, taking into account, that the inclusionary component can only be viably applied to a percentage of the additional rights granted, even a successfully implemented policy is only likely to result in a couple of hundred inclusionary units per year across the city!

5. Issues and Alternative Interventions to Consider

5.1. Incorrect Focus on New Build

In light of the problems discussed above, the question is what needs to be done to address the housing problem? To begin with, it is argued that there is too much focus on the use of new housing to address the problem. This does not make sense as firstly, new build only represents about 1% of the total stock and therefore it is never likely to address the scale needed. Secondly, it is the most expensive stock as current day costs need to be covered and therefore it is counter-intuitive to try address an affordability issue with the most expensive product. Thirdly, new build is usually encumbered with getting land to the point where construction can take place. This involves acquiring land, getting development rights and ensuring adequate infrastructure capacity – the "land production process". This process is currently taking between 2 – 5 years to undertake, which increases the cost, risk and time taken to deliver housing.

A number of initiatives are needed to solve the housing problem and there is no silver-bullet as the answer. However, it is proposed that the following needs to be included in the discussion towards solving the problem.

5.2. Filtering

Firstly, additional stock can be introduced into a sub-market though stock filtering in from other sub-markets. This can occur from higher value sub-markets down into lower value sub-markets and vice-versa. The down-ward filtering of stock has many advantages. To begin with, the fact that the prices paid for new build, higher value stock are more likely to cover the development costs than lower value stock means that more supply is likely to occur. Furthermore, more households are likely to benefit from the addition of higher value stock if, importantly, the downward filtering occurs. This is because if sufficient new supply is introduced into the higher value market, there should be a downward pressure on prices, making houses more affordable to the next value market below. If households from this lower value market move upwards, stock in this lower market becomes available, which should dampen prices, potentially making stock in this market more affordable to households in an even lower market. In short, increased housing supply in higher value markets will benefit more households across a range of housing markets than if one only increased stock in the lower value market.

Key to this though is that sufficient new supply has be introduced into the higher value market to dampen prices and there are sufficient higher income households available to demand a significant amount of higher value stock. This is not really the case in Cape Town where only about 20% of households earn above R20 000 per month. Consequently, whilst an important and viable source of new housing for the city, this supply alone will not come close to addressing the housing shortfall.

Unfortunately, the reverse filtering can occur as well if not enough higher-value stock is supplied and significant gentrification can occur. If insufficient stock is supplied in higher value markets, prices increase and housing becomes unaffordable even to relatively higher income households. In response, these households purchase houses in lower value markets and improve the condition of these houses through renovations, extensions and alterations. The increased effective demand for such houses and the subsequent investment in improvements results in increased house prices and gentrification in these markets, often leading to the displacement of existing households. The evidence suggests that this is happening in Cape Town.

The limited supply of housing in all markets has resulted in there been relatively high average house price growth of about 12%[1] over the past 6 years. However, higher value sub-markets such as the inner city have experienced average growth rates substantially higher than this at between 15 – 20%. These growth rates have had significant impact on a range of sub-markets. It is estimated that 60 000 new houses have been built in the entire city over the past 6 years. However, the number of houses in the sub-markets above R1 500 000 have increased by an estimated 100 000 – 140 000 units. For this to have occurred, houses in lower value sub-markets must have filtered upwards into higher value sub-markets.

[1] The annual growth has reduced recently to approximately 11,5% (FNB, 2017)

In short, there is an affordability squeeze across all the sub-markets on the back of price increases resulting partially from constrained supply. For example, it is estimated that there are approximately 240 000 households earning more than R20 000 per month. Assuming an annual growth rate of 1,5% per annum, this segment grows by 3 600 households per year. However, on average only 1 600 houses valued above R1 200 000 are built per annum – a 56% shortfall. Unlike, lower income households, these households are able to respond to this shortfall by purchasing houses in lower value sub-markets such as Woodstock, which have seen substantial house price increases and gentrification as a result. Interestingly however, the sustained price increases in these lower value markets is now creating an affordability squeeze in these areas as well, which is reflected by the slowing of the number of transactions taking place.

Therefore, while the supply of new higher value housing stock will be insufficient to address the housing shortfall, it is imperative that sufficient stock is supplied into this market to prevent the upward filtering discussed above. It does not make sense to introduce low value stock on one end, only for it to be taken out on the other end. For example, the 100 000 – 140 000 houses that have filtered upwards in the past 6 or so years is about the same amount as all the RDP houses built in the city over the past 20 years. Any housing strategy clearly needs to include higher value supply-side initiatives to "plug this hole".

5.3. Key Intervention Requirements

The trick to addressing the backlog is to overcome the value versus cost hurdle. While higher value new build achieves this to a degree, the limited size of this market means additional strategies are required. Critically four things need to occur. Firstly, the existing stock needs to be utilized and expanded as this represents the bulk of the housing in the city and is the most affordable stock. Secondly, the size of units has to be reduced as lower income households can pay enough to cover the square metre cost of housing but only if the sizes are limited. Thirdly, the land production costs (land, development rights and infrastructure) need to be reduced. Lastly, greater densities have to be achieved to overcome the fixed costs of development and for well-located land to be maximized.

5.4. Current Development Types That Should Be Supported

Currently three forms of development are achieving these requirements but intervention is needed to maximize their potential.

5.4.1. Commercial Conversions

To begin with, depreciated commercial buildings are being redeveloped into residential stock. The current over-supply of A-grade office space and consequent knock-on effect into the B and C-grade office market should offer increasing opportunities in this regard.

5.4.2. “Township Micro-Developments”

Secondly, entrepreneurial small-scale, “micro-developers” are currently redeveloping RDP and market houses in the township areas into medium density, predominantly rental stock. By redeveloping existing stock into small and modest units, the development costs are contained to the degree that the rentals that households can afford generate sufficient returns that encourage developers to provide such stock. Commendably, city officials have been supportive of these initiatives but a more suitable financing model needs to be found. Efforts by financial institutions such as the Trust for Housing Finance (TUHF) should be encouraged in this regard.

5.4.3. Single Residential Redevelopment

The third development involves the expansion of existing formal, single residential stock in the city. Many home-owners are expanding their houses by adding an additional storey, usually through the use of a light-weight, timber or similar structure. The advantages of these expansions are numerous. Firstly, many of these houses are well-located. Secondly, the land production costs are significantly reduced as the land is already owned, development rights usually in place and infrastructure capacity often available. Thirdly, construction costs are lower as a lot of the sub-structure and super-structure elements are in place. Lastly, opportunities exist to retrofit green technology (solar, grey-water etc.) in the houses during the construction process. Besides other benefits, this reduces the impact on the infrastructure capacity caused by the development. As there are about 450 000 single residential houses in the city, the potential to add additional stock in this way is immense.

6. Conclusion

The housing problem is a vexed one and no simple solution exists. However, a number of things need to occur before one can make an attempt to systematically address it. Critically, all the housing sub-markets need to be analysed and tracked as they do not operate independently of each other. In this regard, the efforts of the Centre for Affordable Housing Finance must be commended. Secondly, the economics of housing development need to be understood as the value versus cost hurdle has to be overcome if significant housing is to be delivered. Lastly, the fixation with new build has to be questioned and the use and expansion of the existing housing stock seriously investigated.

Sources:

AMPS (2015) South African Audience Research Foundation.

Centre for Affordable Housing Finance (2017) 2017 *Housing Finance in Africa Yearbook*. http://housingfinanceafrica.org/projects/housing-finance-yearbook/

City of Cape Town (2015) 2015 General Municipal Valuation Roll. City of Cape Town.

City of Cape Town (2017) Land Use & Building Plans Data. Development Application Management System (DAMS).

City of Cape Town (2017) City of Cape Town 2017 Municipal Spatial Development Framework Review. City of Cape Town.

City of Cape Town (2017) City of Cape Town Built Environment Performance Plan 2017/2018. City of Cape Town.

First National Bank (2017) *Property Barometer: FNB City of Cape Town House Price Indices*. https://blog.fnb.co.za/wp-content/uploads/2017/11/Property Barometer Cape Town House Price Indices November 2017.pdf

Lightstone (2018) Woodstock Suburb Property Report.

Property 24 (2018) Woodstock Property Trends and Statistics. https://www.property24.com/cape-town/woodstock/property-trends/10164

Statistics South Africa (2011) South African 2011 Census Data. Statistics South Africa. Pretoria: South African Government.

Statistics South Africa (2016) General Household Survey. Statistics South Africa. Pretoria: South African Government.