



Understanding Financing and Other Decisions of Residential Small-scale And Micro -developers: The Case of South Africa

Project Team:

Prof. Francois Viruly

with

Max Hammer

Prof. Dr. Björn -Martin Kurzrock

Prof. Dr. Carsten Lausberg

Dayni Sanderson

BACKGROUND & OBJECTIVES

- The research focused on small-scale developers who play an important role in providing affordable housing in South Africa.
- The primary research questions focus on the decision-making and financing of these developers.
- This is an increasingly important sector of the SA property market.

WHAT WE CURRENTLY SEE IN THE SPACE : THE BAD & GOOD CONTINUES WITH OR WITHOUT US.....THIS IS A CHALLENGING SPACE



IS THIS THE SA PROPERTY MARKET?

City 'planting' Cape law enforcement to intimidate Woodstock ... [Visit >](#)

human settlements
Department of Human Settlements
REPUBLIC OF SOUTH AFRICA

A COMPREHENSIVE PLAN
FOR THE DEVELOPMENT OF
INTEGRATED SUSTAINABLE
HUMAN SETTLEMENTS

Communities are calling for solutions outside of what is in the current policy

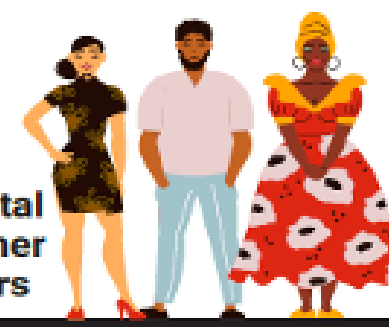
"BREAKING NEW GROUND"

Spectrum of Developers

Subsistence Homeowners











Incremental Homeowner Developers

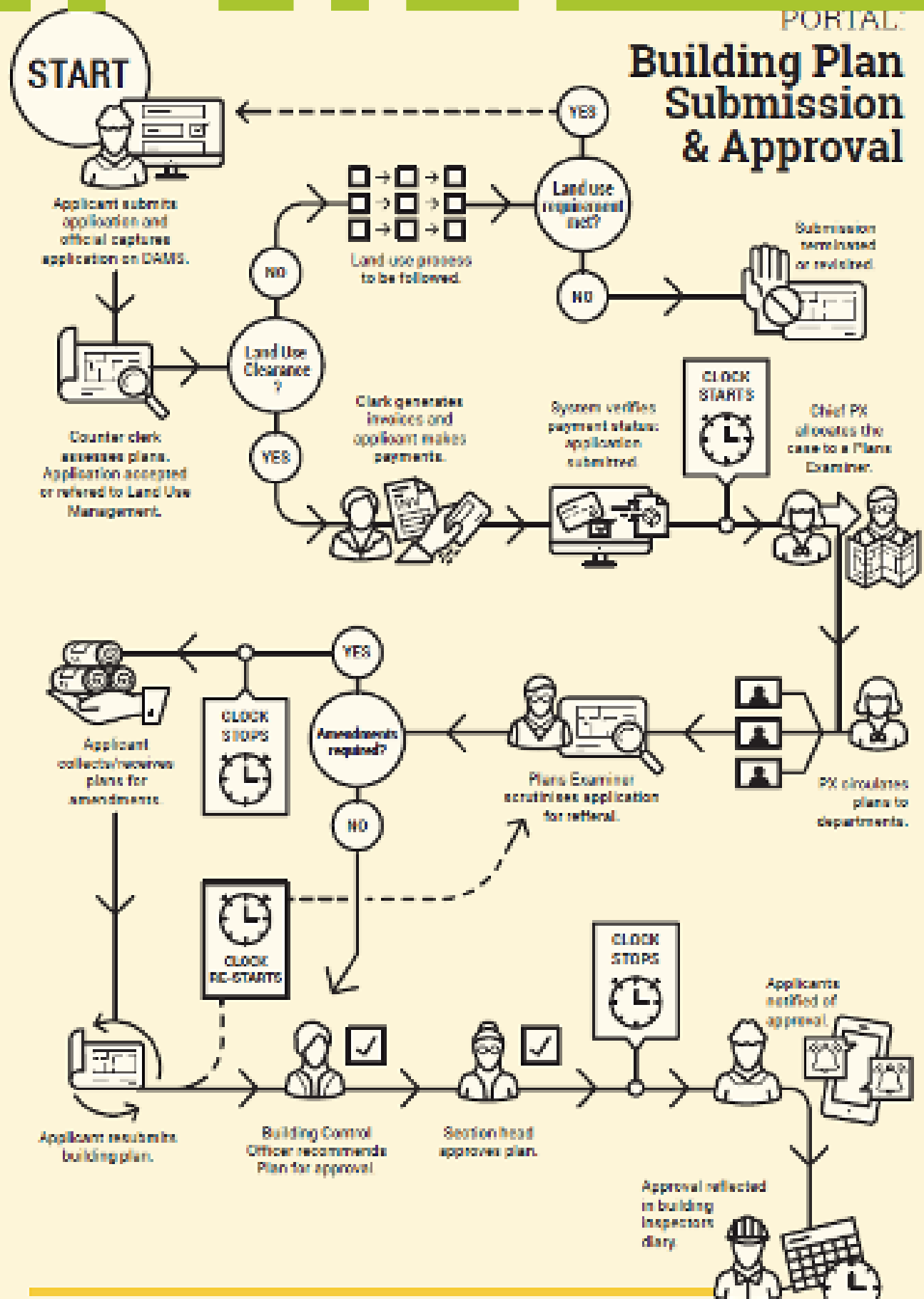


Debt-finance Homeowner Developers



Micro-developers

FACTORS		Subsistence Homeowners	Incremental Homeowner Developers	Debt-finance Homeowner Developers	Micro-developers
Personal factors	Social and/or economic objectives Necessity driven 🏠 Primary Property	Social and/or economic objectives Primary Property 🏠	Economic objectives 🏠+🏠 Primary or additional property	Economic objectives 🏠+🏠 Additional property	
Financial considerations	Incremental, intuitive 🏠 R	Incremental, intuitive 🏠 R	Calculative Project-based 📄 🏠	Calculative Strategic, (portfolio) 📄 🏠	
Economic ecosystem	Personal networks 🤝	Personal networks 🤝	Professional networks 📄 ✍️	Professional networks 📄 ✍️	
TYPOLOGY					
Type of development	Makeshift structures (shacks, wendy houses)	Flats (single or double storey)	Flats (single or double storey)	Apartment blocks	
Relationship to state-subsidised house	Development in backyard of existing house 	Development in backyard of existing house 	Development in backyard of existing house 	Demolishing of existing house to develop full property 	
Examples					



HANDLING THE BARRIERS TO ENTRY



METHODS AND ANALYSIS

- Qualitative Research
- In-depth semi-structured interviews with 11 participants. Taking an exploratory approach that enabled new insights and theories.
- Method of analysis: Combination of deductive and inductive methods.
- Interviews were transcribed and then analysed according to the developed categories.
- A comprehensive interpretation of the data that both confirms existing literature and develops new findings and theories.

LITERATURE REVIEW

- **CHALLENGE OF FINANCING:**

Access to credit limited due to high perceived risks by banks. Very high interest rates (18.25% to 28.25%) place a financial burden on micro-developers (McGaffin et al., 2019, Spiropoulos, 2019).

- **REGULATORY HURDLES:**

Long and complicated approval processes, are often associated with delays and high costs. Complex building regulations often do not correspond to the realities in townships (Scheba and Turok, 2019).

- **BUILDING REQUIREMENTS:**

High standards and requirements for construction quality make projects more difficult (Webster, 2022).

- **ECONOMIC AND SOCIAL RISKS:**

Overcrowding and poor living conditions lead to social tensions. Tenants' economic insecurity makes reliable rent payments and stable business models more difficult (Spiropoulos, 2019)

Decision theory

Normative (mostly neoclassical) decision theory

- Decision-making in general: mostly concerned with prop. investment (e.g., Farragher and Kleiman, 1996; Hargitay et al., 1992)
- Decision-making in property development: several textbooks, but very few empirical works, for instance by Capozza & Li (2002), who set up mathematical rules for the optimal timing of land development projects or Montibeller et al. (2006), who develop a decision support system for strategic decisions

Descriptive (mostly behavioural) decision theory

- General: mostly about investment decisions (e.g., Adair et al., 1994; French, 2001), but some of them relevant for micro developers, for instance by Gallimore (2000) on small property companies and Roberts & Henneberry (2007) on decision processes
- Prop. development: again very scarce; notable examples Healey (1992) with a descriptive institutional model of the development process, and Zöllig & Axhausen (2012), who find that the purpose and professionalism of developers has the greatest influence on their decision-making

Prescriptive decision theory

- General: mostly by authors such as French (2001), who base their suggestion on a review of normative models and a description of common practice
- Prop. development: notable examples are Pommer (2007) and Atherton et al. (2008) who develop tools that can effectively support developers and, thus, help to make decisions more rational and less intuitive

Theoretical framework

Financial theory

Mainstream (mainly neo-classical)

- Hardly applicable to property developers, e.g., portfolio theory
- Practical issues such as sources of capital can be found in textbooks (e.g., Long, 2011; Peiser et al., 2022)
- Some academic research on topics such as mix of financial instruments and capital structure; however, mostly irrelevant for micro-developers (example: peckingorder model and trade-off model not applicable due to the banks' high pre-sales requirements and preference for low leverage (Max and Spolander, 2021))

Off-mainstream

- Several streams of literature provide relevant research findings, e.g., agency theory, transaction cost theory and game theory (example: optimal risk allocation between lenders and borrowers is crucial for success due to information asymmetry)
- Entrepreneurial finance: most of the literature deals with conventional sources of financing (e.g., venture capital), while sources for very small enterprises in developing countries (e.g., peer-to-peer lending and family/friends) are under-researched (Nguyen et al., 2020, p. 22).
- Informal finance: interesting alternatives for our target group (Lee and Persson, 2015; Chikalipah and Makina, 2019)
- Micro-finance: very important sources of capital and advice; organized in several ways (government, national and international NGOs, banks, self-help groups; in South Africa apparently under-developed compared to other countries)



RESEARCH FINDINGS-

DECISION-MAKING PROCESS

- The micro-developers conduct their own market and location analysis, using methods such as interviews, internet research, property comparisons and scoping the potential sites.
- The micro-developers often favour renovations rather than new builds as these are lower risk.
- Strategic planning is crucial, with some developers focusing on long-term income and others planning to sell soon after completion and reinvest elsewhere.
- In addition to economic goals, their focus is often on creating safe and affordable housing to improve the quality of life in the communities.

RESEARCH FINDINGS

FINANCING DECISIONS

- The low level of support from traditional banks, which often do not grant loans due to the high risk involved, requires innovative solutions: Private institutions provide tailored financing solutions, training and support.
- These institutions may be focused more on the feasibility of projects rather than the financial capacity of the individual with more flexible credit terms.
- A challenge: 20% equity requirement. Some programs provide access to mezzanine financing, which offers an alternative when the required equity cannot be fully raised. Different developers use different methods to raise equity, such as the sale of assets or personal savings.
- Downside: These programs offer higher interest rates compared to traditional banks, which further increases the financial burden.

There is therefore a need to attract more financial and other institutions in this field to promote affordable financing for micro -developers.

RESEARCH FINDINGS

PERCEIVED RISKS

- Financial uncertainty
 - Lack and cost of finance
 - Property management
 - Lack of experience and market knowledge.
 - Planning/building regulations
- Crime
 - Unreliable project participants
 - Political instability

CONCLUSION AND FUTURE RESEARCH

