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Challenges Facing Real Estate Development Start-ups in the Inner City of Johannesburg in Accessing Finance from Commercial Banks: A South African Context

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Research Report submitted to the Faculty of Engineering and the Built Environment, University of the Witwatersrand, Johannesburg, in partial fulfilment of the requirements for the degree of Master of Science in Building (Property Development and Management).

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25 JULY 2018

Declaration

I, Leonard Senzangakhona Qwabe, declare that the research work reported in this research report is my own, except where otherwise indicated and acknowledged.
It is submitted for the Master of Science degree in Building (Property Development and Management) at the University of the Witwatersrand, Johannesburg. This research report has not, been submitted either in whole or in part, in any previous application for a degree or diploma to any other universities.

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Signature **Date**

Abstract

Access to finance from commercial banks is a major barrier for Small and medium Business Enterprises (SMEs).The problem persists because of the stringent requirements the commercial banks put on the SMEs. The research attempted to determine whether or not Venture Capital or the Trust for Urban Housing Finance (TUHF) can be alternative sources of finance for inner city residential real estate development start-ups instead of commercial banks.

The research evaluated some of the key reasons that the commercial banks put forth for rejecting SMEs loan application. The study is descriptive in nature, the data was collected using both an electronic survey and a printed questionnaire measuring the primary data sourced from the respondents, who are practising in the inner city property development space. The results are contrary to the expectation of the researcher and the literature reviewed. In the literature, track-record and collateral plays a major role in start-up inner city residential real estate developers lack of access to finance from commercial banks.

The findings, however, show that track-record and collateral have weak relationship with access to finance from commercial banks for the start-up developers. Furthermore, the TUHF as an alternative source of finance had no results because the start-up real estate developers from the TUHF did not participate in large numbers. Venture capital as an alternative source of finance has a weak relationship with access to finance from commercial banks. Hence, venture capital cannot be seen as an alternative source of finance from commercial banks.

Dedication

I dedicate this research report to my dearly departed brother and sister, Muzikayifani Alexander Qwabe and Tholakele Maria Qwabe.

Gone too soon!!!

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To my family and friends, without you, one would not have the licence to dream and to be unapologetic about it. So, I thank you.

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List of Abbreviations

SMEs	Small and Medium Business Enterprises
TUHF	Trust for Urban Housing Finance
NDP	National Development Plan
SAVCA	South African Venture Capital Association
VC	Venture Capital
REITs	Real Estate Investment Trusts
TPPE	Training Programme for Property Entrepreneurs
UCT	University of Cape Town
UDZ	Urban Development Zones
CID	City Improvements Districts
CBD	Central Business District
IDP	Integrated Development Plan
COJ	City of Johannesburg
JDA	Johannesburg Development Agency
JPC	Johannesburg Property Company
OECD	Organisation for Economic Co-operation and Development

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Chapter One: Introduction

1.0 Introduction

Entrepreneurship is at the cornerstone of solving South Africa's developmental issues, economic growth and enforcing stability (Fatoki, 2010). However, according to Turton and Herrington (2013), cited in (Fatoki, 2014), South Africa's Total Early Entrepreneur (TEA) activity fell from 9.1% in 2011 to 7.3% in 2012. This sets South Africa below the 14% average benchmark of efficiency-driven countries. The Gross Domestic Product (GDP) for the first quarter of 2016 plummeted by 1.2% (Statistics South Africa, 2016) and the unemployment rate is currently estimated around 26.7% (Statistics South Africa, 2016). This is a challenge because South Africa is plagued by unemployment, inequality and poverty.

Fatoki and Asah (2011) have identified Small Medium Enterprises (SMEs) as a crucial vehicle that can be used in growing the economy, lowering the unemployment rate and alleviating poverty. Yet, SMEs in South Africa are experiencing limited or no funding at all. The country has been ranked among the top three countries with barriers to entry for SMEs in numerous studies (Underhill Corporate Solutions, 2011). Entrepreneurs find it challenging to access finance for a myriad of reasons (Irwin and Scott, 2010). This is reinforced by the 75% of small firm's loan applications that are rejected by banks (Fatoki and Odeyemi, 2010). Therefore new SMEs entering the market are seen as a panacea to South Africa's developmental issues (Fatoki, 2014).

Consequently, there seems to be stringent requirements from the banks regarding financing SMEs. The obligations can only be met by seasoned companies, for example, collateral and business track record requirements. However, since SMEs are heavily reliant on commercial banks' support for their continued existence (Netswera, 2001), the study warrants an investigation into the factors preventing SMEs from obtaining finance.

These barriers to finance are dire to start-ups and emerging real estate developers, since they are heavily dependent on short-term bank loans, mortgages and hire purchases to finance development (Attakora-Amaniamopong, 2006; Attakora-Amaniampong, E.;2006; Owusu-Manu, Edwards, Badu, Donkor-HyiamanandLove, 2015; Jahur, Sultanaand and Shahidullah, 2006; Lam, Chang and Chan, 2011; Miller, 2015). About 75% of real estate developers use a

combination of equity and debt financing to fund their development projects regardless of the number of years in the property development business (Hall and Lowies, 2010).

Moreover, there is a direct relationship between lending behaviour to SMEs and the business cycle which further exacerbates the barriers to finance, this becomes more apparent in times of economic downturn, when commercial banks curtail their lending (Seo, 2013). Under such economic conditions SMEs battle to access debt and equity finance and this constrains business activity, which results in slow economic growth ,and ultimately puts pressure on poverty alleviation as well as employment (Mazanai and Fatoki, 2012).

Owusu-Manu et al., 2015 purports that amongst an array of reasons, the barriers to finance for SMEs include the following:

- Size of the company
- Incomplete or inadequate financial statement
- Short track record
- Age of company
- Experience,
- Inadequate risk assessment
- Diversification mechanism
- Lack of collateral
- Higher financing costs.

Ordinarily, SMEs are likely to have high default rates and to be informationally opaque; hence the difficulty in obtaining alternative financing sources other than banks (Coetzee and Buys, 2017). Furthermore, due to the banks being risk averse, SMEs are the most affected when lending money as opposed to larger firms (Bbenkele, 2007; Irwin and Scott, 2010; Kotey, 1999).

Primarily commercial banks are concerned with extending credit to finance commercial activities, infrastructure construction, to charge interest on their loans and stimulate economic growth in the process. SMEs are a crucial component in growing the economy and banking development (Liang, 2012). However, commercial banks do not lend funds to informationally opaque SMEs, this information asymmetry is a major barrier in acquiring finance (MacAnBhaird, Vidal, and Lucey, 2016; Seo, 2013), because there is a positive relationship between business information and access to finance by SMEs (Fatoki and Asah, 2011).

Track record presents a problem for real estate development start-ups because they do not have a reliable credit history of servicing their developmental loans, hence there high chances of rejection (Liang, 2012; Owusu-Manu et al., 2015). The data available is mostly on the barriers to accessing finance that SMEs across the board experience. Therefore, the study attempted to find out the barriers that maybe particular to residential real estate SMEs operating in the inner city of Johannesburg development space.

1.1 The Problem Statement

The problem is the stringent requirements placed by commercial banks on SMEs that prevent SMEs from acquiring finance from commercial banks. There is approximately 91% of SMEs that need external finance to fund their business endeavours, which further demonstrates the reliance of SMEs on commercial banks in South Africa. But, only 39% of SMEs manage to access finance from commercial banks (Fatoki and Asah, 2011). Access to finance is a massive concern for SMEs; on a global scale hence the reliance on banks to fund their operations (Coetzee and Buys, 2017 and Mazanai and Fatoki 2012). The reluctance of banks to fund real estate acquisitions, development and construction happens for various reasons. Key among them is the inability of banks to extend finance to entrepreneurs who do not possess the adequate collateral and adequate book keeping. If the finance is extended, then it is usually accompanied with high interest rates (Likotsi, 2014 and Owusu-Manu et al, 2015).

Hence the high rejection rate coupled with the high cost of servicing the loan has a negative impact on the total returns of the development project (Cameron, Holme and Rapport, 1990).This ultimately has a knock-on effect on economic growth of the country and is prevalent in emerging economies like South Africa (Wattanaprutipaisan, 2002). This assertion is further compounded by the estimated 75% of SMEs that failed within the first two years of operation due to inaccessibility of debt finance in South Africa (Fatoki and Odeyeni, 2010;Likotsi, 2014; Fatoki and Asah,2011).

Real estate development is one of the key sectors in strengthening the economic activities of a country (Botha, Adendorff and Smallwood, 2014). This assertion is echoed by the 34% GDP contribution by real estate development in the year 2014 to the South African economy (Statistics South Africa, 2016). Henceforth, residential real estate developers play a crucial role in bolstering the economy. However, the continued barriers to finance can negatively impact a country's built-environment and stunt its growth (Coiacetto and Bryant, 2014). Only

SMEs with good collateral have a good chance of obtaining commercial bank finance, because collateral is a major factor in deciding whether or not to finance SMEs (Fatoki and Asah, 2011 and Liang,2012).Therefore, a major obstacle for development and growth of firms as well as working capital is access to finance (Kasseeah, Ancharaz and Tandrayen-Ragoobur, 2013).

There is a financial gap that exists in funding SMEs in South Africa. There seem to be a discrepancy in what the commercial banks are saying and what SMEs are doing. This disconnect contributes to the financial gap since SMEs and Commercial banks are not singing from the same hymn (Coetzee, 2017). Furthermore, this financial gap is estimated to be around 80% in OECD countries and about 90% in non-OECD countries (Mazanai and Fatoki, 2012). This is reinforced by the 75% of small firm's loan applications that are rejected by banks (Fatoki and Odeyemi, 2010). Therefore, this data makes a strong case for the perceived financial gap in South Africa.

1.2 Research Questions

Why are South African commercial banks, reluctant to offer acquisition, development and construction finance to start-up residential real estate developers in the inner City of Johannesburg? And, can venture capital and or The Trust for Urban Housing Finance be considered as an option?

1.3 Aim of the Research

The aim of the research was to develop a better understanding of the barriers from commercial banks on to SMEs operating in inner city residential real estate development in South Africa Johannesburg, from accessing finance to SMEs operating in inner city residential real estate development in South Africa.

1.4 Objectives of the Study

The objectives of the study were as follows:

- Identifying the factors that influence funding for start-up residential real estate developers from commercial banks.
- To examine the challenges faced by start-up real estate development SMEs operating in the inner city of Johannesburg in obtaining finance and the real estate development phase that carries the most financial risk.
- To evaluate whether Venture capital or the Trust for Urban Housing Finance can be a funding option for real estate start-ups in the inner City of Johannesburg to finance residential real estate development.

1.5 Significance of the Study

Real estate development is a major contributor to the South African economy and job creation. It also provides the much-needed infrastructure; hence the study attempted to understand the barriers experienced by real estate development start-ups regarding acquiring finance from commercial banks to fund residential real estate development in the inner city of Johannesburg. The study also set out to find out whether venture capital or the Trust for Urban Housing Finance can be used as an option to fund residential real estate property developers in the inner city.

The study provides stakeholders, especially the City of Johannesburg Municipality (COJ), Johannesburg Development Agency (JDA) and Johannesburg Property Company (JPC) with a better understanding of the options available to start-up residential real estate development SMEs to change the dilapidated office and residential stock in the inner city of Johannesburg. This will assist the COJ to find better ways to create an enabling environment for SMEs to flourish therefore, eradicate the slums and change the face of the inner city.

The attempt was to give stakeholders involved in the development process the funding options available to them and to sought their perspective on the funding options through a survey. Therefore, this study contributes to the information available on SMEs, by providing primary data and analysed findings on access to finance and the challenges faced by residential real estate development SMEs operating in the inner city of Johannesburg.

1.6 Methodological Approach

The study is positivist in nature, thus associated with quantitative data analysis. A survey questionnaire was used to collect the primary data from the participants. Purposive sampling was employed to select the stakeholders in the property sector such as residential property developers in the inner City of Johannesburg. The data was analysed using descriptive and correlation analyses to help answer the research question and reliable conclusions drawn about the barriers to finance for residential real estate developers in the inner city.

1.7 Scope of the Study

Short-term and long-term loans for private real estate developers forms the research scope of this study. Despite many studies on SMEs and lack of access to finance in South Africa, a study on real estate development start-ups operating in the inner City of Johannesburg and the challenges in accessing finance has not yet been explored and whether or not venture capital or the TUHF can be used as a funding model. The study relates to the South African context as a whole. However, the province chosen for a comprehensive analysis and discussion is Gauteng, particularly the City of Johannesburg. The Johannesburg's central business district has a lot of opportunities for residential property developers to convert old dilapidated office buildings into residential space. The Gauteng province is the second province that has a lot of venture capital transactions after the Western Cape province.

1.8 Limitations

There is limited secondary data on venture capitalists because venture capital is relatively new in South Africa. Secondary data is also scarce because the model that the TUHF uses is quite unique since they find individuals from all walks of life who are interested in residential real estate development in the inner city of Johannesburg. The study was based in Gauteng province in Johannesburg because that is where many venture capital transactions occur after the Western Cape Province and the TUHF has a lot of their clients operating in the inner city. The primary data was collected using questionnaires because they are easier to administer and cost effective. Inferences and conclusions after analysing primary data using descriptive and correlation analysis as earlier outlined. The sample size was limited due to time constrains.

1.9 Research report structure

The research report is structured into five chapters;

- Chapter 1: This as an introductory chapter where the aim, objectives, research problems and the research questions of the study are discussed.
- Chapter 2: This chapter reviewed the existing literature on the focus area of the study to reveal the existing avenues available as sources of finance for real estate developers in general and start-up residential real estate developers in the inner city of Johannesburg, as well as the phases of development and associated risk.
- Chapter 3: This chapter is an overview on the research design and discusses the data collection and analytical techniques selected for conducting this research.
- Chapter 4: This chapter analyses and discusses the findings research and compares it with the findings in the literature reviewed and the knowledge gained.
- Chapter 5: This chapter provides a summary of the entire study and articulates the main findings and conclusions of the research, offer recommendations and areas of further research.

Chapter Two: Literature Review

2.0 Introduction

This chapter reviewed existing literature relevant to this study. This chapter examines the conceptual framework of real estate financing as well as general practises and development process. The following are covered in the chapter:

- The development process and phases is discussed and it's associated to risk to better gain an understanding of the development phases and the financial risk involved in in each phase.
- The introduction to the real estate financing process and general practices and the factors that influences the lenders decisions to grant development loans.
- In order to understand the nature and characteristics of venture capital in South Africa, literature from the venture capital association of South Africa was discussed.
- The financing model used by the Trust for Urban Housing Finance is discussed to gain a better understanding of the criteria they use to lend to start-up inner city residential real estate developers in Johannesburg.
- Johannesburg inner city regeneration is discussed, to gauge the city's efforts in rejuvenating and re-developing failing office spaces into attractive residential units for low-income earners.

2.1 Property development process and the risk associated with phases of development

"Property development is a high risk entrepreneurial activity. It involves executing expensive projects with long gestation periods in an uncertain environment and into an uncertain future." (Coiacetto and Bryant, 2014: 305)

Real estate development is the creation and management of space-time, it varies in complexity depending on the design, hence each real estate project is unique. Therefore, the development process comprises of different phases from inception to completion, such as construction, financing, marketing, administrative controls and rehabilitation needed to operate the real estate enterprise for a number of years (Grasskamp, 1981).

Real estate development also encompasses the use of scarce resources and large sum of capital for the development of a product that is largely indivisible and illiquid (Ibid). Real

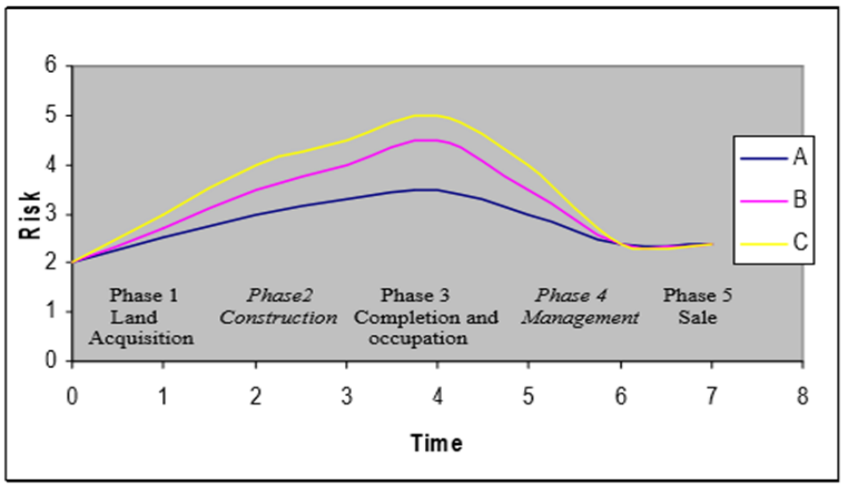
estate development forms a fundamental part of the sustainability and viability of the built environment (Botha et al., 2014). These sentiments are echoed by Squires and Heurkens (2016), who show that real estate development influences the strategies employed in planning the built environment and informs how individuals conduct their lives on a daily basis.

Real estate development is a risky undertaking; an understanding of the variables involved and their contribution to the risk of finance is imperative. Real estate developers assume a lot of financial risk, such as fluctuating interest rates. If a construction loan is based on floating interest rates, then constructions delays may render the project unachievable because of higher debt service payments (Loizou and French, 2012; Reed, Sims and Cadman, 2015).

The property development process is characterised by risk (ibid). Because of the amount of capital involved, the risk encountered at every phase of the process, therefore, requires seamless planning (Das, Sah, Sharma,Singh and Galuppo, 2013). About 62,5% of property developers perform a property market risk assessment when deciding whether or not to pursue a development. Risk assessment entails techniques such as preparing financial feasibility models, analysing the project using pre-determined financial performance benchmarks, calculating the internal rate of return, preparing a sensitivity analysis, preparing discount cash flow models, probability models and risk simulations (Newell and Steglick, 2006).

Figure 1 shows the typical phases of real estate development risk. These are: (1) is the acquisition of the land, (2) construction of the structure, (3) final completion and leasing out of the property, (4) management of the asset after handover, (5) the sale of the property if the developer is not planning to hold the property or the exit strategy after a number of years of holding the asset. All of these phases have varied risks. The first 3 phases are associated with high risk, at phase 4 the risk subsides because the property might be sufficiently let and the eventual sale of the property after the holding period (Attakora-Amaniampong et al., 2006).

Figure 1: Phases of real estate development risk



(A) Lower than normal predevelopment leasing, completion behind schedule
(B) Normal predevelopment leasing, completion on schedule
(C) Greater than normal predevelopment leasing, completion ahead of schedule

Source: Bruggeman and Fisher (2005) as cited by (Attakora-Amaniampong et al., 2006: 10).

Dullisear (2001) and Newell and Steglick (2006) highlight a few risks associated with the development process as follows:

Pre-construction risk: the main risk is the experience of the developer and builder; hence a track record of successful developments will put a developer in a better stead. Market risk: critically evaluate the location and factors and the timing of release of the project to the market. Feasibility risk: is the main risk in the development process, it is utilised to gauge the viability of the projects if it can be rejected or accepted.

Contract-negotiation risk: This phase financial risk, building contract risk, acquisition and land cost risk. During the contract negotiation phase measures need to be taken to make sure that the contractual obligations are understood and followed.

Formal-commitment risk: it is a key phase in the development process. All the contracts are signed at this stage. For example, all tenants' contracts are signed and they know when they are to assume occupation.

Construction risk: one of the stages with highest risks, it is associated with cost overruns, time delays and project management risk. If this risk is not mitigated correctly, the development may fail.

Post-construction risk: is concerned with delivery timing risk and if the development is to be disposed, then it needs to be disposed at a profit.

Real estate property developers' start-ups are more concerned with the risk associated with formal commitment, construction and post-construction phases. The banks need to know the risk involve in developing a property in order to price and mitigate the risk. Therefore, the cost of borrowing tends to be high.

2.2 Overview of Real Estate Finance

Property developers usually do not have the capital required to finance a development from inception to completion. As such, they usually rely on a third party, such as a lender or financier, for funding. The lender charges interest on the capital and administration costs on the loan extended to the developer. Hence the loan fills the financial difference between the developer's available equity and the total cost of the project including all associated expenses over the development period until completion. Furthermore, a developer has two options for financing a development, short-term finance which pays for the initial development cost such as (acquisition of land, construction costs, professional and marketing costs) and long-term finance which aids the developer to reimburse their short-term loan and either realise their profit through selling or holding the property as an investments with tenants (ibid).

2.2.1 Sources of Finance

Developers use a combination of their own equity and debt from lending institutions to finance developments. The lending institution concerned assumes a certain amount of risk by extending finance to the developer. In turn, it charges interest and service charge which is in line with the level of risk exposure, inflation and allowance for profit. A developer needs to choose a financier or financial institution, which complements the type of project to be undertaken, because after the global recession lending regulations have become stringent hence loans are harder to obtain, costly and also require a larger amount of equity on the developer's part, another source of funding property development is Real Estate Investment Trusts (REITs) (ibid).

2.2.2 Financial Institutions

Financial institutions, or financiers, are expressions used in the property sector to describe pension funds, insurance companies, life assurance companies, investment trusts, unit trusts, banks, etc. These institutions invest in property directly or indirectly through shares ownership in property investment companies and property development companies which differ from investment in REITs that are traded on the stock/share market (ibid).

2.2.3 Banks and Building Societies

Banks participate in the property development sector for various reasons, including the possible growth in capital and rental values and reasonably security and low-risk investment, particularly when dealing with prime property. However, due to exposure to bad debts when the market is not performing well, banks have become risk averse, when it comes to investing in speculative developments. They, thus, tend to restrict lending to high-risk borrowers and reduce their overall level of bad debts (ibid).

The lenders primary goal is to ensure a return on their loan, which pays them for their exposure to risk. The risk assumed is determined by borrower's ability to:

- Not be able to regularly service the debt on a monthly basis
- Unable to pay the money at all
- If the borrower defaults, the minimum amount the property could be sold to recover their losses.

The bank utilised its own operating policy and other factors to come up with a criteria to assess loan applications these include :

- Size of the development
- Track record and history of the development company
- The nature and size of the development
- Total length of the loan
- The amount of equity the developer is willing to offer
- Profits and cash flow of the development company
- The ability of the developer to complete the project and the overall viability of the scheme.

If the developer decides to hold the completed development for a certain period, or until first rent review, the bank will want assurance that the rental income derived will be able to service the loan (ibid).

2.2.4 Real Estate Investment Trusts (REITs)

REITs are used as a vehicle for the securitisation of property or real estate in many countries including USA, UK, Australia and Singapore, and recently, South Africa. REITs have benefits such as taxation incentives, availability of up to date information about the REIT and being traded publicly on the stock market.

Reed et al. (2015), RICS (2007), and Stockton (2012) purport that REITs help to facilitate the development of high quality residential letting market and increases prospects of accelerated residential development over the medium to long term. However, there are limitations associated with REITs such as:

- Initiation costs associated with listing on the stock market are significantly large
- Marketing and strategy costs are quite high
- Not all investors will subscribe to the Initial Public Offering (IPO)
- Real estate market that is performing well may offer higher yields at times that a REIT cannot match regardless of the tax incentive.

South African REITs usually have a stake in a number of commercial real estate such as office buildings, shopping malls, factories, hotels, warehouses and hospitals. They also own residential real estate, although to a lesser degree, in cities and towns across the country as well as investing in properties abroad (SAREIT, 2013).

There are two kinds of REITs that exist in South Africa; Company REITs and Trust REITs. SAREITs (2013) defines them as follows:

COMPANY REITs:

- The shareholders in a Company REIT are active participants and they are fully protected by the Companies Act and Takeovers Regulations Panel. Shareholders can vote on specific issues pertaining to the company in a (annual) general meeting and they can vote for the company to be a REIT.

- The company will have its REIT structure documented in its memorandum of incorporation.
- Continuing compliance with the JSE's listing requirements and the Companies Act is the obligation of the Company directors.
- The company management and/or property administration may be either internal or external.

TRUST REITs:

- An application to the JSE and proof of compliance with the JSE Listing Requirements and that registration with the Registrar of Collective Investment Schemes guarantees an existing PUT will become a SA REIT.
- The interest of investors' are protected by a trust deed and the trustee, whose main responsibility is to make sure that compliance with the Collective Investment Schemes Control Act is in order, thereby safeguarding investors' assets
- The Trust REIT is not subject to the Takeovers Regulations, but they need to observe all JSE listing requirements.
- Trustees have to account to the Registrar and are obligated to meet all the requirements of the Collective Investment Schemes Control Act.
- The Trust REIT has to possess an external asset and property manager in order to comply with the Collective Investment Schemes Control Act.

Currently all SA REITs own income producing property and both existing PLSs and PUTs were able to adopt the REIT regularity framework, as set out by JSE (SAREIT, 2013).

According to SAREITs (2013), the following is the list of requirements to accomplish REIT status and to be a JSE-listed company:

- The applicant must own at least R300 millions of property
- The applicant must keep its debt below 60% of its gross asset value
- The applicant must earn 75% of its income from rental or from property owned or investment income from indirect property ownership
- The applicant must have a committee to monitor risk and not enter into derivative instruments that are not in the ordinary course of business
- The applicant must pay at least 75% of its taxable earnings available for distribution to its investors each year.

Listed Company REITs and Trust REITs both qualify for the REIT tax dispensation and are publically traded on the JSE REIT board (SAREIT, 2013).

2.2.5 Joint Venture Partners

A development company may utilise a partnership or form a joint venture company with a third party as a vehicle to raise finance or secure acquisition of land or to carry out a development. The main reason for a developer to form a partnership is to access finance or secure land in return for a share in the profits of the development or Joint Venture Company. In a joint venture, the parties involved in a development usually distribute the profits in equal shares (ibid).

Joint venturing has the potential of growing the business of participating companies. However, due to the risks associated with the construction industry, joint ventures are inherently risky because one has to choose the right partner and partner selection involves reputation, inter-partner trust, experience, personal knowledge of the partner organisations, commitment and human resource management ; negotiating the contract (Adnan, 2008; Adnan, Chong and Morledge, 2011).

But, sometimes it is the only means of accessing finance or securing land for a development scheme. Therefore, if a joint venture is entered into the risk is spread through the partnership or joint venture arrangement. A joint venture is usually formed with companies who have the required capability and knowledge of a specific type of development and these companies are perceived to be a vital piece in the success of the scheme (ibid). Therefore, the formation of joint ventures helps companies to solve problems such as lack of opportunities, lack of financial capability, lack of management skills, plant and equipment (Minja, Kikwasi and Thwala, 2012).

2.2.6 Government Assistance

There is an assortment of government grants available to developers, which are dependent on the availability for funding and the social benefits that such assistance will bring to the community. Many of these projects are designed to encourage developers to undertake projects, which have components of renewal or gentrification of old buildings of geographical areas.

In many cases, the financial enticements for a developer to undertake the project would not be enough. However, the social benefits from the government`s perspective are abundant, for an example, low cost rental housing and new retail centre that provide employment for the community (ibid).

2.2.7 Methods of Development Finance

The accessibility and choice of finance will depend largely on factors such as company size, financial strength, track record, features of the development scheme to be financed and the duration of the scheme (ibid).

2.2.8 Bank Loans

Various approaches to bank lending have been introduced of late, such as development companies pursuing long term bank finance beyond the construction period up to the first rent review, mezzanine finance which helps the developer bridge the shortfall between equity and a first mortgage. For a developer borrowing from the bank permits great flexibility and enables the developer to benefit from all of the growth, unless some of the equity is given away. The developer can repay or refinance the debt from the bank when the time is right and sell the completed investment at a higher price. Therefore, in a well performing market the rents and capital values are rising fast, hence it is more profitable for the developer to arrange debt finance as opposed to equity finance (ibid).

2.2.9 Mortgages

Mortgages are the original and common form of long-term development finance. A mortgage is a loan secured on a property whereby the borrower has to repay the capital loan plus interest by a certain date. However, not many lenders are interested in long-term non-equity participating loans such as mortgages. The lender views a mortgage as a fixed-income investment that is very illiquid. While banks provide mortgages, however, the availability of the mortgages is limited due to the problem of the “reverse yield gap” (Reed et al, 2015).

Mortgages are divided into two categories; residential and commercial mortgages. Residential mortgages are predominately available to owner occupied single-family homes,

while commercial mortgages are for income producing properties (Geltner, MillerClayton and Eichholotz 2007). Mortgages are normally granted on a loan-to-value ratio basis between 60 to 80% depending on the risk involved. The amount of mortgage being secured will depend on the security being offered by the borrowers in relation to the quality of the property, the financial standing of the tenant and the borrower (ibid).

Income producing buildings and residential development can be financed through permanent or construction loan. Construction loans are usually short term ranging from one to three-year periods, while permanent commercial mortgages have a five to ten year horizon. The lender advances the cash gradually in construction loans in line with the progress of the project and the borrower start paying on completion of the project. However, permanent loans are treated differently, that is, the cash is advanced once off as a lump sum and the borrower is expected to pay back the principal with interest gradually over the life of the loan (ibid).

2.3 Overview of Venture Capital and Venture Capital in South Africa

2.3.1 Venture Capital

There is no mainstream or regulatory definition of venture capitalist, but they usually undertake long-term investments, which are high risk and high return. Venture capital is apt for businesses that have a measurable level of uncertainty and lack of track record, collateral and information asymmetry (Ojah and Mokoaleli-Mokoteli, 2010). This sentiment is echoed by (Rosenbusch, Brinckmann and Muller, 2013), who note that venture capitalists supply equity finance with no collateral for their investment to firms who do not have positive cash flows and growth prospects. In this way, they assume the risk of the funded firm. Thus, venture capital is perceived as a private equity fund designed for entrepreneurs (privately held) businesses with exciting products and concepts not yet tested in the consumer market.

Banks are the quintessential sources of funding in South Africa; however, SMEs are failing to accesses finance from the banks. Therefore venture capital can serve as a conduit that provides the necessary finance required by entrepreneurs for their businesses to thrive (Ojah and Mokoaleli-Mokoteli, 2010).

The very nature of the venture capital in private equity is tailor made for entrepreneur SMEs as it is designed to address the in-efficiencies of conventional capital markets. The ideal world for entrepreneurs would be a world with an abundance of access to external finance

either debt or equity, because entrepreneurs who have access to external funding are contributing positively in the countries by growing the economy and creating employment (Ojah, 2009).

Venture capital organisations utilise donor contributions for investing in early stage businesses that offer high potential with high risk. Hence, real estate development is a perfect fit. These organisations are professionally managed and they invest in equity linked securities of private ventures at different stages of their development. The structure and function of venture capital organisation is to support start-ups with the finance needed in a cost effective way despite the challenges of information asymmetry, collateral, track record, etc., which conventional capital market organisations such as commercial banks are unable to offer (Sahlman, 1990).

Rosenbusch, Brinckmann and Muller (2013) purport that venture capital is able to generate above average performance in environments associated with high risk by:

- Selecting ventures that are promising in emerging industries.
- Extending financial resources and support to the selected ventures

However, there's inconclusive empirical proof that venture capital increases the chances of the funded firm to perform better in high risk environments. The findings of Rosenbusch, Brinckmann and Muller (2013) show that:

- There is minor evidence of encouraging positive performance effect of venture capital investments, but as soon researchers control for industry type selection the positive effects are diminished.
- Performance effects are mainly concerned with firms growth, while profits are not necessary a priority.
- Performance effects are diminished if the firms receiving the funds and support of a venture capital are either very young or very mature.
- Venture capital is seen as losing its value if and when the funded firm goes public.

The literature suggests that venture capital can create value by developing mechanisms such as:

- Screening, selecting, staging and monitoring individual investments (Baum and Silverman, 2004; Kaplan and Stromberg, 2001)

- mitigate against the risk emanating from uncertainty and syndication by diversifying their portfolio (Manigart, Lockett, Meuleman, Wright, Landstrom, Bruining, Desbrie'res and Hommel, 2006)

A number of scholars questioning whether or not venture capital benefits the funded firm, the proponents of venture capital are of the view that venture capitalist are in a position to choose promising emerging industries and firms and provide value to them. The benefits derived by those firms and industries are the provision of financial resources and value-add functions such as managerial resources, access to the venture capital's social capital and efficient use of resources (Sahlman,1990, Kaplan and Stromberg, 2004).

However, on the other hand, scholars who are against venture capitalist believe that due to the risky nature of entrepreneurial endeavours, it is difficult for the venture capitalist to systematically identify promising ventures. Furthermore, the level of risk may lead to exorbitant transactions costs, which the venture capitalist can pass to the funded firm post investment in order to improve their own returns. Moreover, if the interest of the venture capitalist and the funded firm are not aligned, then the venture capitalist might persuade the funded firm/ entrepreneur to pursue strategies that benefits their exit plans (Gompers, 1996).

Brav and Gompers (1997) found that companies funded by venture capitalist performs slightly better than companies that are not backed by venture capitalist, when using equal weighted average returns. This does not mean to say all venture capitalist fail to add a considerable amount of value to the funded firms. However, Busenitz, Fiet and Moesel (2004) found that there is no statistically significance that supports the assumption that venture capitalist on average add value to the funded firm by providing information in addition to the capital they invest. Furthermore, Barney,Busenitz, Fiet and Moesel (1996) and Jelic,Saadouni and Wright (2005) found non-conclusive evidence that supports the notion associated with the performance of implications of venture capital investments.

Belden, Keeley and Knaap (2001) found that venture capital funded firms that go public are able compete with public firms that have been around for many years. Furthermore, venture capitalist backed companies have faster sales and asset growth. However, Jain et al. (2008) found that the involvement of can have dire consequences for funded firms to attain IPO profitability. Additionally, venture capital leads to a decline in the likelihood of profitability and an increase in time to profitability.

Venture capitals do not invest in all sectors equally, but select specific industries. Venture capital largely funds industries such as software and biotechnology and excludes industries such as hotel and lodging (Lee and Wahal 2004), Venture capitalist pursue technological inclined industries because they are more likely to succeed compared to the general economy (Zacharakis, 2007).

Therefore, there seem to be a disagreement on the value added by venture capitalist to emerging entrepreneurial firms seeking access to finance. This study will attempt to examine if venture capital can be considered as an option to fund start up real estate developers.

2.3.2 Venture Capital in South Africa

According to the South African Venture Capital Association (SAVCA, 2015), Venture Capital survey, the definition for Venture Capital is:

"A subset of the private equity asset class, which deals with predominantly equity funding of high-tech, high-growth-potential businesses, whose growth is achieved typically through radical global scaling".(SAVCA Venture Capital Survey, 2015:05)

"The need for VC stems from the specific requirements of such businesses in the start-up and early growth phases, and from the part that experienced VC fund managers can play in structuring and nurturing investments into these businesses."(SAVCA Venture Capital Survey, 2015:05)

The state of venture capital over a ten-year period (2006-2015) in South Africa is displayed in Table1 below. Between 2006 and 2009, there was a sharp increase of funds because there were new funds such as Hasso Platter, Ventures Africa, 4Di Capital entering the venture capital investment space. The period 2009 to 2012 saw a decline in venture capital investment. This was due to the venture capitalist investment cycle after the four-year period. Usually some venture capitalists exit the market as part of their exit strategy. Although the global recession took place around the same time, the decline was not the impact of the economic downturn. After the four-year period, the cycle will start again from securing finance to find the next deals to invest in again.

Table 1: Deal trends over time

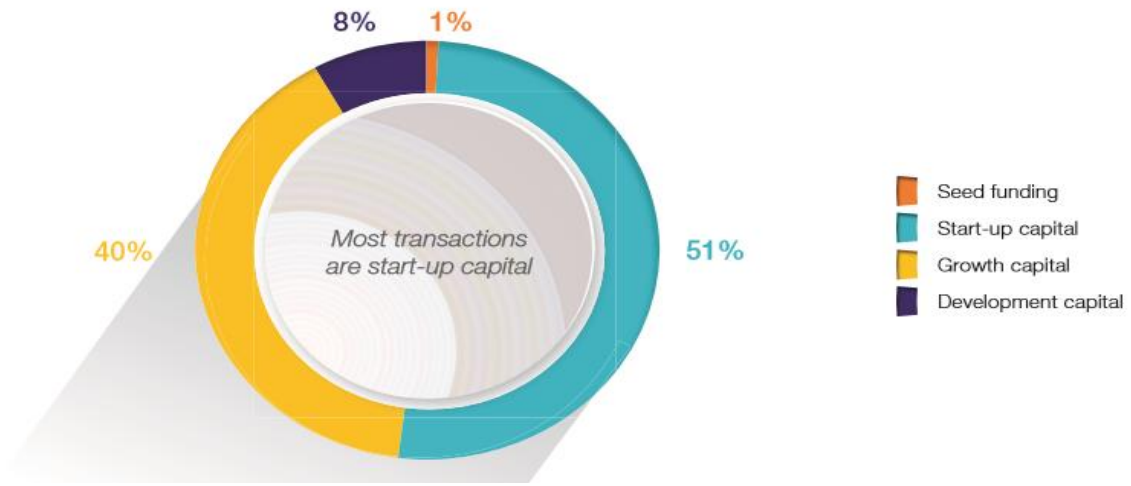
Year	Total amount invested (R million)	Deals done	Average deal value (R million)
2006	304.1	38	8.0
2007	467.6	47	9.9
2008	551.2	56	9.8
2009	242.3	37	6.5
2010	194.3	25	7.8
2011	210.6	26	8.1
2012	281.9	11	25.6
2013	108.7	18	6.0
2014	141.7	34	4.2
2015[i]	146.3	43	3.4
10 years	2, 581.7	315	8.2
(2015 YTD)	(79.2)	(23)	(3.4)

[i] Year-to-date figures for 2015 are annualised to enable comparison. Note that all survey data, graphs and tables in this report use actual, not annualised data, except where expressly indicated to the contrary, as in this table.

Source: SAVCA venture capital survey (2015)

Figure 2 shows that South African investors are keen in funding early stage transactions followed by growth capital as opposed to seed funding and development capital. However, some investors have expressed preference for developmental capital of late.

Figure 2: The category per stage of the deal



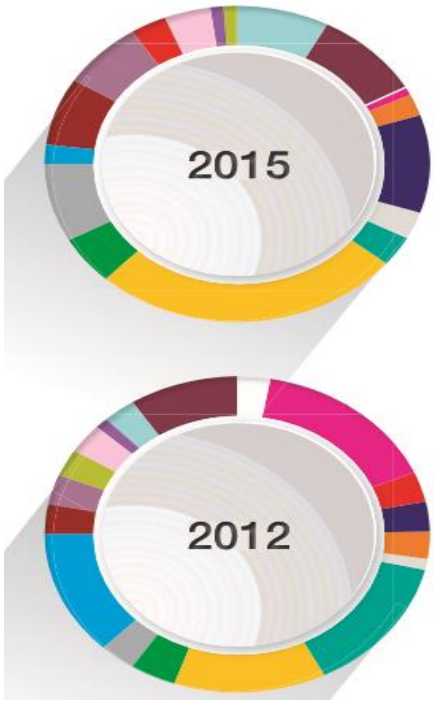
Source: SAVCA venture capital survey (2015)

Figure 3 shows that most of the deals concluded by venture capitalist in South Africa are in the ICT-related sectors, for example, software is 26%, e-commerce is 10%, electronics 4% and media/entertainment 7%. All of these sectors contribute to almost 50% of the deals

reported. The SAVCA (2015) results are parallel to the SAVCA (2016) results, which also showed the ICT-related sectors to be leading all other sectors.

The notable changes venture capital investment in sector allocation between the 2012 and 2015 are in software, telecommunication and medical devices, these sectors registered gains and declines ranging from, 13% to 26%, 16% to less than 1% and 13% to 2%, respectively. The software sector doubled the amount of deals concluded between 2012 and 2015.

Figure 3: Industry sector allocation of venture capital in South Africa

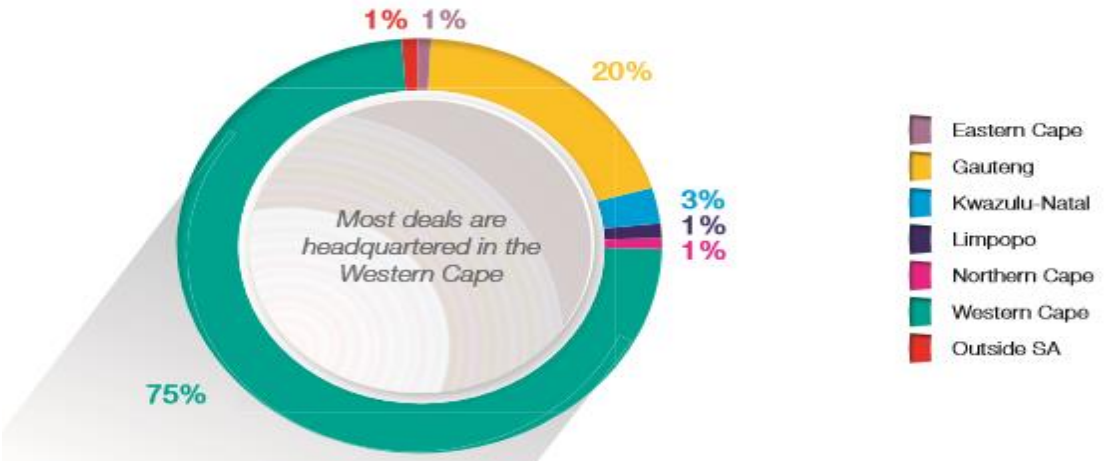


	2015	2012
Manufacturing	8%	3%
Health	9%	9%
Pharmaceutical	0%	3%
Telecommunications	1%	16%
Retail/Distribution	2%	3%
e-Commerce	10%	3%
Security technology	3%	1%
Energy	3%	14%
Software	26%	13%
Consumer products & services	5%	4%
Business products & services	8%	3%
Medical devices & equipment	2%	13%
Media/Entertainment	7%	3%
Financial services	7%	3%
Food & beverages	3%	3%
Electronics/Instrumentation	4%	3%
Mining, mineral & chemical processing	1%	1%
Agriculture	1%	3%

Source: SAVCA venture capital survey (2015)

Figure 4 shows that 75% of the venture capital deals are concluded in the Western Cape, and about 20% in the Gauteng province. This confirms that a number of entrepreneurs, angel investors and independent fund managers have settled in the Western Cape.

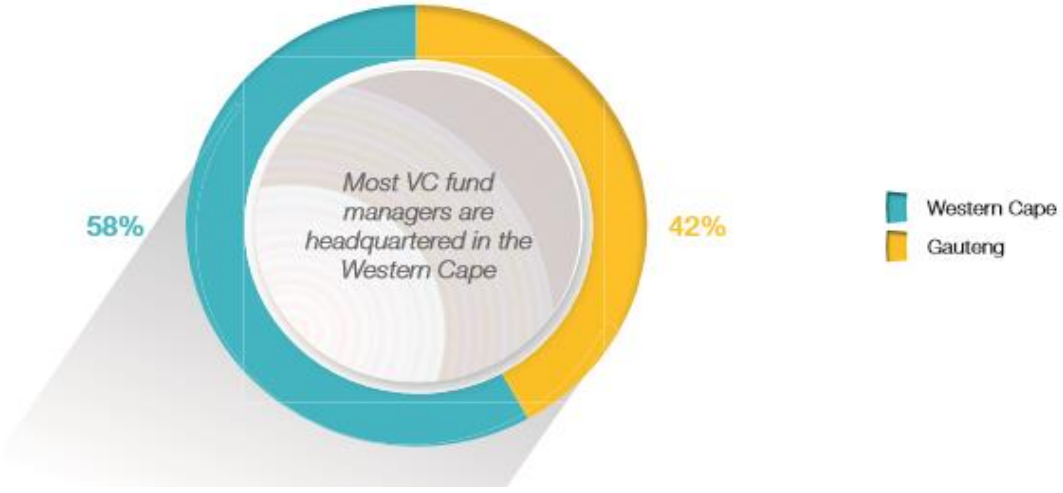
Figure 4: The locations of venture capital transactions



Source: SAVCA venture capital survey (2015)

Most fund managers offices are based in the Western Cape, the allure of the province stems from increased high-tech business activity, a maturing start-up ecosystem, a clustering of early-stage investors, and the lifestyle that the Western Cape is offering, which has the potential to launch their careers because of the investment opportunities and their disposal.

Figure 5: The Location of fund managers



Source: SAVCA venture capital survey (2015)

2.4 The Trust for Urban Housing Finance Financing Model

The Trust for Urban Housing Finance (TUHF) is a non–bank institution specialising in inner city housing development lending space. TUHF was conceptualised in 2001 by leading South African organisations in the development finance environment to provide cost effective lending solution to inner city real estate developers and help to overcome the challenges faced by these developer.

TUHF's criteria for lending is very inclusive, anybody who is willing and able can apply for access to finance. They originate, underwrite and service the loan to SMEs to purchase and eventually refurbish or renovate the buildings, usually old office space or light industrial and green fields into predominately affordable rental residential dwellings in the inner cities of South Africa. Access to debt capital is considered a major stumbling block/constraint for growth by TUHF. Hence, the lending is based on a project's feasibility and not the applicant's balance sheet and the loan term is 15 years, which is longer than the industry norm of 10 years.

These reasons set TUHF apart from the industry because they can lend to individuals who show entrepreneurship and business potential as the only criteria. These individuals do not meet the traditional criteria for accessing debt capital. Therefore, TUHF captures this segment of the market and lends a lifeline, by implementing a thorough due diligence and good loan management structures. The success of each SME is dependent on the type of real estate project they embark on, competence as real estate entrepreneur and the type of training and mentoring they receive from TUHF.

2.4.1 Key Performance Areas Used by TUHF

Figure 6 shows the key performance areas that TUHF measures its success

Figure 6: The key performance areas

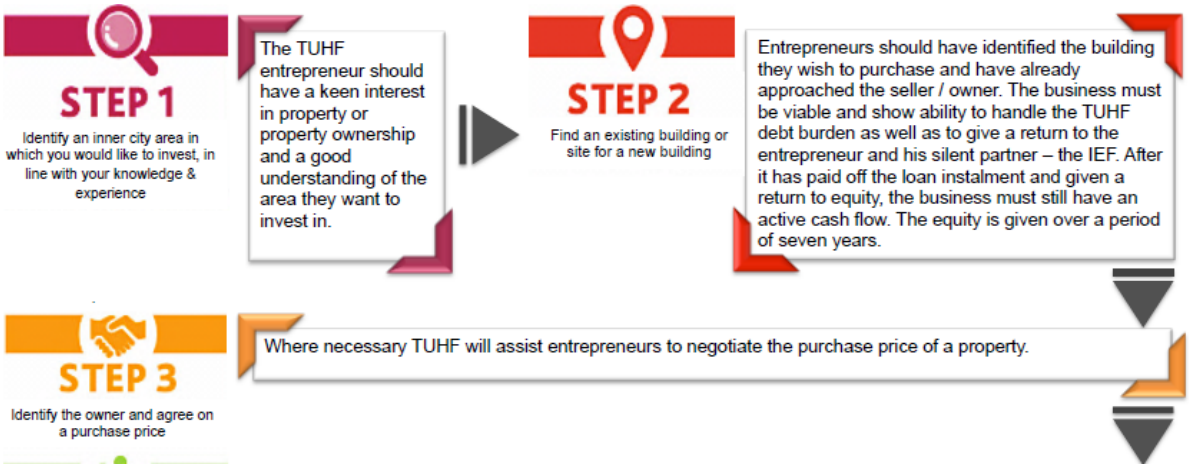


Source: TUHF Job Fund Case Study (2017)

2.5.2 TUHF Lending Methodology

Figure 7 below illustrates the methodology used by TUHF to lend to inner city residential real estate developers.

Figure 7: The TUHF lending methodology



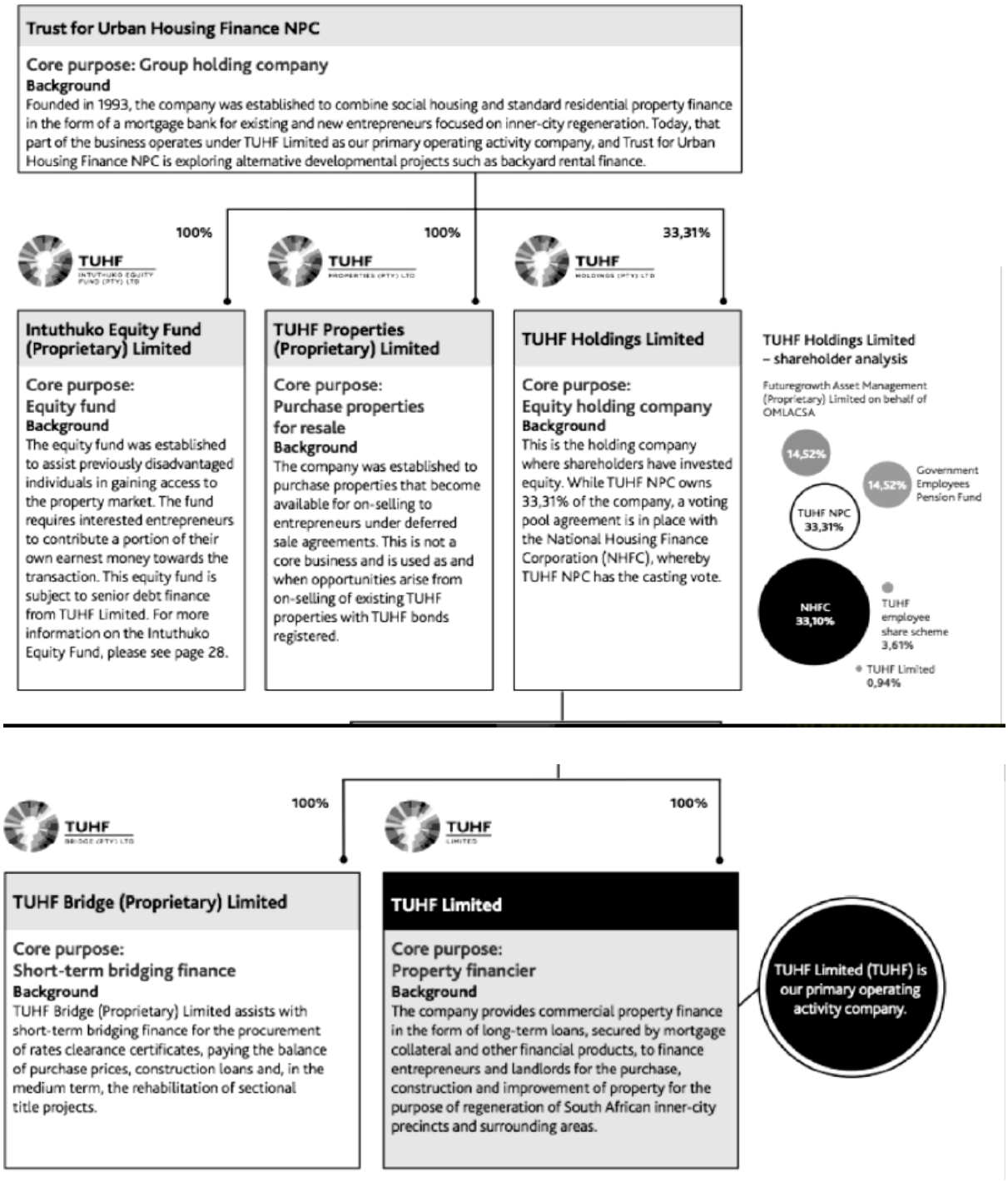


Source: TUHF Job Fund Case Study (2017)

2.4.3 Trust for Urban Housing Finance Financing Structure

Figure 8 shows the financing structure that TUHF to finance start-up inner city residential real estate developers.

Figure 8: The TUHF Financing structure



Source: TUHF Job Fund Case Study (2017)

2.4.4 Property Finance at TUHF

Property Finance: TUHF provides finance for inner city mixed use developments up to the value of R50 million; of which the largest component should be residential. TUHF invests in projects from small semi-detached houses up to buildings with many hundreds of units. The deals engaged in consist of the following type of transactions:

- Purchase only – no construction or refurbishment
- Purchase plus construction including refurbishment
- Construction only (includes refurbishment, conversion or new build)
- Conversion from office space to a light industrial building to residential
- Equity release (a loan facility against increased or residual value for the acquisition or improvement of another (different) property)
- Refinance (either an increase of an existing loan or refinancing a third party bondholder for the property)
- New build
- Owners who live in an inner city building and wish to buy more units to become a landlord.

2.4.5 Bridging Finance at TUHF

Bridging Finance: TUHF's Bridging Finance covers short-term loans up to 6 months to enable entrepreneurs to cover temporary needs, where quick decision-making is required when purchasing inner city property. Bridging finance may be required for:

- Rates Clearance Certificates
- Balance of purchase price (early profit release) to buyers and sellers – for example, property auctions or where funds are required before registration of transfer
- Profit from the sale of property
- VAT refunds
- Related transfer transaction costs (for example, transfer duty)
- Cost-to-client is based on the level of security available with the highest price being for unsecured loans.

Together with the Gauteng Partnership Fund, TUHF has set up the **Intuthuko Equity Fund (IEF).** By contributing to the deposit of own equity requirements necessary for a loan approval, the fund assists previously disadvantaged South Africans (in certain occupations and income groups) who wish to enter the rental housing industry. TUHF does not provide 100% finance. The IEF requires interested entrepreneurs to contribute their own capital towards the transaction. The Intuthuko Equity Fund mainly targets caretakers, property

managers, artisans in the construction industry, police, fire men and women and nurses, focusing mainly on those who live or work in the inner city. How it works:

- The fund will only finance a deal that makes business sense, one that earns enough money from the business, not only to repay TUHF's loan with interest, but also to make a profit. This profit is then shared between the buyer and the Intuthuko Equity Fund in a way that supports him to grow his business.
- The IEF will match the entrepreneurs' own cash to a maximum of R200 000
- The contribution to the deposit is done by IEF as a 'silent partner' who quietly supports the entrepreneur in the background
- This deposit allows the entrepreneur to raise a substantial loan from TUHF which is enough to purchase and refurbish a property
- In return, the IEF claims a 40% partnership in the 'business'
- The IEF can however be 'bought out' at any time
- The TUHF loan can be repaid over a period of up to 15 years.

Transfers and subsidies are primarily development loans (TUHF evaluation data, 2017 cited in TUHF jobs case study (2017)

- The project aims to finance approximately 200 new and existing SMEs to purchase and construct an estimated 200 residential buildings with 7,600 residential units. The loan size per SME is estimated at R5 million payable over a 15-year period. Since receiving Job Fund support, TUHF has established 150 deals at an average of just under R9 million, totalling R1.346 billion at an average interest rate of prime plus 3.4% (where the lowest interest rate granted is prime plus 1.5% and the highest so far is prime plus 5%) over 15 years. Most deals are approximately 2 years old. By Q3 2016, 92% of the approved loan facility had been disbursed, 13.7% of the disbursed loans had been repaid with an additional 15.5% in interest paid against disbursed loans.

- Of the 150 deals: 122 are Johannesburg properties, 15 in Port Elizabeth, 12 in Durban and 1 in Bloemfontein.
- Of the 150 deals:

- 80 are classified as Purchase Plus, which includes construction and refurbishment with 3 Purchase only
- 35 are Refinance: It should be noted that the refinancing deals do not fit into the Jobs Fund job definition, unless the refinancing has some form of refurbishment; however 23% are refinance deals
- 22 are Conversions from office space to a light industrial building to residential
- 6 are new construction projects; and are considered refurbishments.
- The total 150 clients funded: 35 are starter businesses (clients who are in the process of developing and owning their first building, or, who have developed and own one building. This client segment has a revenue of < = R5 million), 74 are considered emerging (Emerging SMEs are clients who have stepped up their portfolios, working on two to five buildings, having built a reputation as a reliable client, this portfolio of clients has revenue of R5 – 30 million) and 41 are already established (Established SMEs are clients that have a revenue that is >= R30 million)

While TUHF has 49% emerging SMEs, established SMEs constitute the lion share 59% in terms of the value of deals concluded. Only 38% of SMEs are black owned; however, 47% of supported entrepreneurs are PDIs. In terms of deal value, 74% of loan value is extended to non-PDI entrepreneurs, with 56% still being extended to established SMEs.

2.4.6 SME Development at TUHF

The services provided by TUHF offers opportunities that are hard to come by within the grasp of enterprising individuals, enabling them to break away from the cycle of poverty through carefully managed entrepreneurial ventures. The project is directed at ordinary men and women who live and/or work in inner cities and who have an interest in becoming housing entrepreneurs, who either directly employ or service industry counterparts.

The support/ mentorship programme funded by TUHF's R7 million matched contribution is twofold:

- The first tier involves support by the loan officer who originates the deal. It is the role of the loan officer to identify and discuss the client's unique business support needs at origination and handhold the client throughout their journey.

- The second tier is the TUHF training programme for property entrepreneurs (TPPE), which was established in 2015 in partnership with the University of Cape Town. This is a 6-month programme that incorporates contact and online training sessions. The training with UCT is designed to address most business needs highlighted by clients or from the training needs survey that was conducted in 2016. By the end of Q3 2016, 25 entrepreneurs had completed this training.

A network of contacts, building visits and general problem solving interactions are woven into the more formal functions and presentations with wider groupings of successful SME businesses.

TUHF reports that the mentorship programme propels the entrepreneurs mentored to gain a better understanding of the dynamics in their projects/ portfolio, their growth strategy in relation to their current standing and the tools they need to develop and manage their business. TUHF's loan officers endeavour to foster good relationships with the clients in their portfolio and engage with them regularly. This relationship management strategy is effectively used to manage the loan, mitigate risk and gain a competitive edge.

The business development support plans indicate an intention to understand and meet the unique support needs of their clients. Currently, TUHF offers the same services across all client segments. SMEs consider the content useful, starter SMEs require much more comprehensive training and/or mentorship and closer support by the loan officers. The cost to an average SME is variable based on the value of the loan funding. At an average R9 million loan over 15 years at the average interest rate of prime plus 3.4%, a SME would pay back 2.355 times the original loan at approximately 1.31% per month or R1.413 million in profit a year just to breakeven, with an expectation of 18% revenue growth.

TUHF currently extends loans at interest rates higher than commercial banks due to the perceived higher risk of TUHF's loans. While TUHF segments their clients according to size and the number of loans, there is only a 2% variation in interest rates not attached necessarily to a client segment. As a result, more established clients are looking elsewhere for funding as the TUHF finance and service offering becomes less competitive. According to the July 2017 mid -term evaluation report, TUHF is cognisant of the limitations of the current service

offering and are considering how to customize their service offering to different client segments.

2.5 Residential re-development in Johannesburg CBD (inner city regeneration)

Section 26 of the constitution of the Republic of South Africa clearly states that everyone has the right to have access to adequate housing, and the State must endeavour to use all its resources on its disposal for the realisation of this right. An estimated half of the South African households are living below the minimum wage of R 1254 for a family of six. Furthermore, the families that fall within this bracket do not qualify for mortgage loans.

The National Development Plan (NDP) , 2015) sets out the spatial transformation vision for 2030 for South Africa it articulates that a larger proportion of the population should live closer to places of work, and the transport they use to commute should be safe, reliable and energy efficient.

For the NDP's vision to be realised the following measures needs to be in place:

- Prevent development of housing in marginal places
- Increase urban densities to support public transport and educe sprawl
- Ensure reliable and affordable transport and better coordination between various modes of transport
- Provide incentives and programmes to shift jobs and investment towards the dense townships with on the urban edge
- Foster focused partnerships with the private sector to bridge the housing gap market

The Gauteng is a much urbanised province comprising of three South African major metropolitan areas namely, Johannesburg, Tshwane and Ekurhuleni metropolitan municipalities. About 97% of the Gauteng population lives in urban areas. Furthermore, the province continues to attract a significant number of people both locally and internationally in search of employment opportunities and a better life, which ultimately puts pressure on infrastructure and service delivery (Gauteng Local Government and Traditional Affairs Annual Report, 2013).

According to the Executive Director of the United Nations Habitat in Nairobi, Dr Joan Clos, it is essential to have a national urban policy that can be transformed into local initiatives.

Furthermore, urbanisation should be seen as an opportunity rather than a challenge because it goes in tandem with development (United Nation Department of Public Information, 2016). In South Africa currently a national policy framework that addresses or supports urban renewal is non-existent. Although there are programmes linked to legislation such as the Urban Development Zones, still there are no concrete programmes for urban renewal (TUHF job fund case study, 2017).

Gauteng and the Western Cape have strategies for urban regeneration. However, they are not linked to delivery mechanism. Urban regeneration endeavours in these Metros are usually built around the policy framework of City Improvements Districts (CID), which is utilised to fight 'crime and grime' problems with the government investing in infrastructure to stimulate private investment. But more often than not there is no mention of provision of low- and middle-income households or social housing in these strategies (TUHF job fund case study, 2017).

In the late 1980's the City of Johannesburg was engulfed by urban decay which lead to the degeneration of the value of the properties around the city. In 1998 the city filed for bankruptcy which necessitated a bail out from the national treasury and the eventual creation of the municipality and the start of urban regeneration. This presented the opportunities to developers to convert inner city buildings into affordable rental housing. This invigorated a wave of regeneration of the inner city in conjunction with government regeneration programmes (Bethlem, 2013).

The main driver for investment in the Central Business District (CBD) over the past several years was the alteration of the office block asset classes to residential units. Private entrepreneur developers took advantage of regenerating the CBD to provide affordable residential accommodation. However, these opportunities did not come without challenges. These include difficult in accessing finance, dealing with hijacked buildings, and rent collection problems. Some of the developers, nonetheless, overcame these challenges and achieved growth. More importantly, the demand of the residential units outstrips supply (Bethlem, 2013).

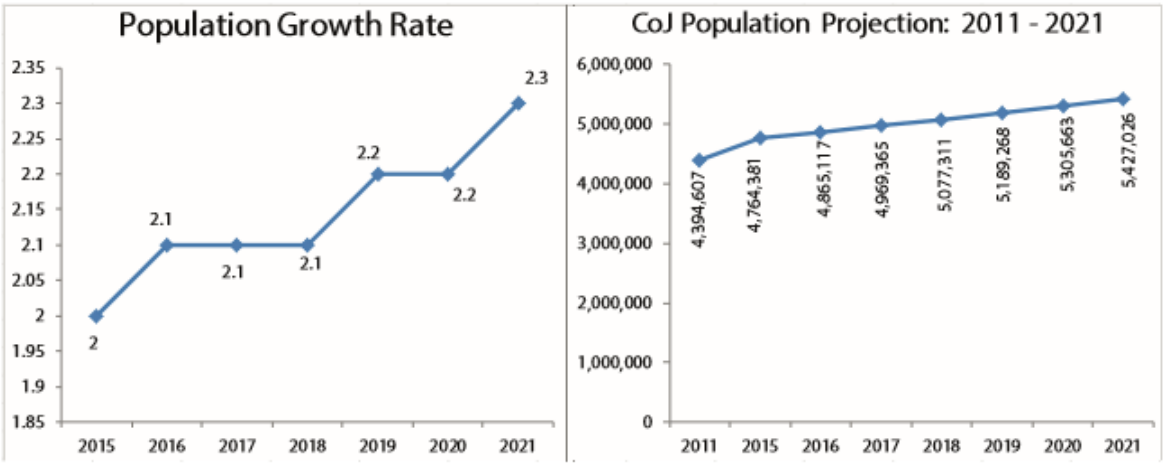
The Johannesburg inner city charter projected the formation of an inner city housing plan which is aimed at developing affordable residential accommodation in the inner city. The housing plan was expected to have achieved 75,000 residential units by 2015 (The Housing Development Agency, 2013). The main factors driving the increase in the conversion and

construction of new residential buildings within city centres are demographics, housing requirements, planning policies, availability of suitable vacant buildings and sites and economic incentives for the developers (Rhodes and Wilkinson, 2006).

The current populations of the City of Johannesburg is approximately 4.8 million people. It is the largest metropolitan by population size in South Africa (Integrated Development Plan, 2016).

According to Figure 6 below the population increase in COJ is estimated to be about 4.86 million in the middle of 2016 to be about 5.3 million in the middle of 2021. The growth rate is projected to be roughly 2.0% and to 2.3% per annum.

Figure 9: The projected population and growth in City of Johannesburg (COJ)

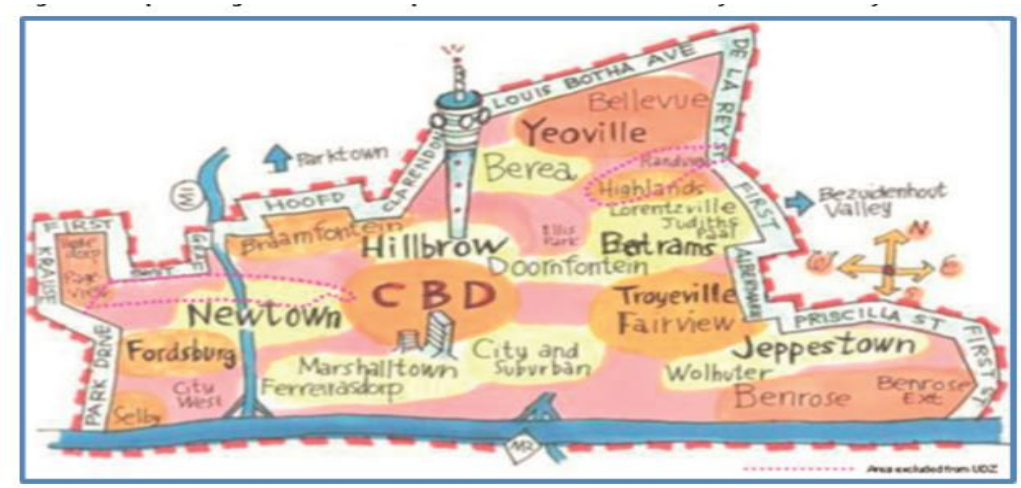


Source: IDP (2016)

The inner city precincts of Johannesburg have a lot of challenges such as bad buildings that are poorly maintained and managed. However, the city is encouraging economic development and job creation through urban development zones (UDZ) and offering tax reductions to private developers (IDP, 2016).

Figure 10 below shows the urban development zones boundaries of the inner city of Johannesburg where development is incentivised through tax breaks.

Figure 10: The Urban Development Zone Boundaries of the Inner City



Source: IDP (2016)

The urban development zones tax incentive is meant to encourage inner city renewal in South Africa (IMIESA, 2005). Furthermore, the income tax Act No 88 0f 1962 permits developers to write off costs of refurbishments/ new development in delineated urban redevelopment zones. Hence, residential property developers can charge Vat at 14% when selling their units. They can claim vat on the cost of supplies they use such as material (Strauss, 2016).

2.6 Chapter Summary

This section reviewed the real estate development phases and process, the associated financial risks, inner city regeneration, real estate finance options, venture capital as whole and venture capital in South Africa and the Trust for Urban Housing Finance. The literature reviewed is based on international and South African studies. This study focuses on South Africa and the inner City of Johannesburg.

Commercial banks have stringent requirements such as collateral, track record, age of company, size of the company, etc. Because of these requirements, SMEs find it difficult to access finance from these institutions for they do not meet the criteria. Other options for funding have been explored. Among others they include mortgages, joint ventures, venture capital, the TUHF and REITs to gauge their lending criterion.

Property development is a high risk high return industry, hence commercial banks' reluctance on funding start-up real estate developers. On the other hand, venture capital is also a high

risk and high return industry, therefore, the need to explore whether or not venture capital can mitigate the finance problem is worthwhile.

The central problem is the absence of financial services for real estate investment in major inner cities, and particularly for PDIs. Hence, by focusing on the inner city, the TUHF operates in areas where traditional funders are not eager to invest. Due to the redlining policies of commercial banks, TUHF fills the gap that exist in the market by providing access to finance, support, guidance and risk management for new and existing entrepreneurs. With a clientele from all walks of life, TUHF aids in the purchase, and subsequently conversion or refurbishment of buildings in the inner cities of South Africa. These developments lead to affordable residential units.

Chapter Three: Research Design and Methodology

3.0 Introduction

This chapter discusses research design and methods employed to investigate the stringent requirements placed by commercial banks on small- to medium-sized residential real estate developers in the inner City of Johannesburg in South Africa. The types of data collected as well as discussion of analytical techniques employed. Data limitations and ethical considerations considered in the study are also covered.

3.1. Sampling Design

Although SMEs in general have been studied extensively, the potential role of venture capital or the Trust for Urban Housing Finance as an option for financing start-up real estate developers in South Africa has not been studied well. Primary data in the form of questionnaires was collected in the execution of the study. This was necessary since there is very little secondary data for venture capital that could be used.

The study used non-probability sampling. The population comprised of SMEs in the inner city residential property development space. The respondents were selected from the general population in Johannesburg. The study attempted to get representatives from the TUHF start-up in the inner city residential property development space. The selection criterion was based on location, size, history product type and objectives of the study. This enabled the study to gauge the perception of start-up residential real estate developers in using venture capital and the Trust for Urban Housing Finance as an option for funding.

The population within the inner city residential property development space is fairly large. Hence it would be an arduous task to collect data from each individual stakeholder in the population. Therefore a sample was selected and to offer their perception on venture capital or TUHF as an option for inner city residential property developers (Naidoo, 2014).

The targeted respondents were inner city residential real estate developers that are active in the property sector in Johannesburg. A questionnaire was used to collect the necessary primary data for the analysis of the research problem. All the participants were encouraged to answer independently and to the best of their abilities, without any fear of favour, and their anonymity were was assured (Leedy and Ormrod, 2010).

3.2. Sample type and Data Collection

Purposive sampling was used in the study. The sampling mirrored the objectives and the nature of the research. The respondents were selected from active participants in the property sector in Johannesburg. This approach was adopted to provide clarity and depth to the problem of access to finance and offer some insight on whether venture capital or TUHF can be used as vehicle to fund start-up property developers.

The measurement scale that all questions were based is an ordinal scale, which classifies values into categories and rankings and the nominal scale which classifies data into categories with no ranking (Berenson, Levine and Krehbiel, 2012).

The questionnaires were sent via email to the relevant stakeholders in the property sector. The questionnaires were also printed in hard copies and handed to participants. A 5-point Likert scale was used to gather the opinions of the sampled participants. The Likert scale displayed the degree to which the participants agree (Agree; strongly agree), disagree (Disagree; strongly disagree) or neutral (Neither agrees nor Agree). All participants, who were earlier contacted, had given permission that the questionnaire be send to them.

3.2.1 Survey

The survey questionnaire is a descriptive study. There are a total of 28 questions in the questionnaire. Chapter 4 provides a discussion and analysis of the responses to the questions asked in the survey. The results of the survey questionnaire were analysed using correlation analysis and graphical methods such as pie and bar charts. The survey questionnaire is presented below:

SMEs Questionnaire Survey

Due to the business cycle and the information asymmetry, lack of track record, size of the company among others reasons, SMEs battle to access finance from commercial banks. Inner city residential developments are associated with high risk hence commercial banks are reluctant to finance such endeavours due to the reasons mentioned above. This study attempts to find out whether the Trust Urban Housing Financing model is a viable option for start-ups real estate developers who are interested in the inner city rejuvenation development space.

The Trust Urban Housing Financing model criteria for funding will be compared with the criteria that the banks utilise for funding, to establish whether or not the reasons the banks put forward for rejecting applications for finance of Small and medium enterprises in the real estate development space are valid or not. Therefore, the small medium enterprises will rate the reasons put forth by the banks to test if they are material or not.

Section 1: General Demographics of the Firm

1. How many persons are currently employed in your company in full or part-time capacity?

- 1-9
- 10-49
- 50-249
- 250+

2. How would you characterise your company is it?

- Joint venture
- Venture capital
- Sole trader

3. How do you describe your company ?

- Start-up
- Emerging
- Established

4. What is the core business of your company?

- Inner city residential real estate development company
- Banking
- Venture capitalist

5. How many years has the company been operational?

- 5 years
- 2 years or more but less than 5 years
- Less than 2 years

6. Who are the owners of your company?

- Family or entrepreneur
- Venture capital firm
- Other

7. What position do you occupy in the company?

- Owner
- Director
- Senior manager
- Manage

Section 2: Situation of the firm

Which Phase of Property Development you consider to be carrying more financial risk (8 to 11)

8. Pre-construction phase

- Strongly agree
- Agree
- Neutral
- Strongly disagree
- Disagree

9. Contract negotiation phase

- Strongly agree
- Agree
- Neutral
- Disagree
- Strongly disagree

10. Formal commitment phase

- Strongly agree
- Agree
- Neutral
- Disagree
- Strongly disagree

11. Construction phase

- Strongly agree
- Agree
- Neutral
- Disagree
- Strongly disagree

12. Do you depend on commercial banks for finance?

- Yes
- No

13. Access to finance is presently the most persistent problem your company is facing?

- Yes
- No

14. What source of financing structure is your company using?

- Bank loan
- Mortgages
- External equity investors
- Joint venture
- Trust for Urban Housing Finance (TUHF)
- Other

15. If the answer to 14 is TUHF, is acquisition, property development and construction financing accessible at TUHF?

- Yes
- No

16. What criteria does TUHF utilise for granting of loans, chose from the table below: Indicate answer with (x)

CRITERIA	YES	NO
Size of the company		
Collateral		
Track-record		
Information asymmetry		
Expertise/experience		
Financial statement		
Age of the company		

17. Do you have an increased need for external financing for working capital?

- Yes
- No

18. Did you apply for a bank loan?

- Applied
- Did not apply because of likely to be rejected
- Did not apply because of lack of collateral
- Did not apply because of other reasons

19. If applied

- Applied and got the whole thing
- Applied but got the portion of it
- Applied but declined because cost of borrowing was too high
- Applied but rejected

Section 3: Reasons that commercial banks put forth as basis for rejecting SMEs loan applications

20. Should the size of the company be a barrier in accessing bank finance?

- Strongly agree
- Agree
- Neutral
- Disagree
- Strongly disagree

21. Should the lack of collateral be a barrier in accessing bank finance?

- Strongly agree
- Agree
- Neutral
- Disagree
- Strongly disagree

22. Should the lack of a track record of company be a barrier in accessing bank finance?

- Strongly agree
- Agree
- Neutral
- Disagree
- Strongly disagree

23. Should Information asymmetry be a barrier in accessing bank finance?

- Strongly agree
- Agree
- Neutral
- Disagree
- Strongly disagree

24. Should the lack of expertise/experience be a barrier in accessing bank finance?

- Strongly agree
- Agree
- Neutral
- Disagree
- Strongly disagree

25. Should Inadequate financial statements be a barrier in accessing finance from the banks?

- Strongly agree
- Agree
- Neutral
- Disagree
- Strongly disagree

26. Should the age of the company be a barrier in accessing bank finance?

- Strongly agree
- Agree
- Neutral
- Disagree
- Strongly disagree

27. Do you receive venture capital as a source of funding for your company?

- Yes
- No

28. Would you consider TUHF as an alternative source of funding to commercial bank funding?

- Yes
- No

3.3. Data analysis and discussion

The study was descriptive in nature; the results of the questionnaire were analysed using graphical analysis using bar charts, frequency, histogram et cetera (Naidoo, 2014). The responses to the questionnaire are both ordinal and nominal in nature and therefore a non-parametric test statistical test was apt for the study (McHugh, 2013).

The statistical test assessed the strength of the relationship between pairs of variables, where a variation in one variable was accompanied by a variation in another variable. A correlation coefficient allowed the researcher to quantify the strength of the linear relationship among any two ranked variables of concern. Correlation coefficient is denoted by (r), which indicates the strength and direction of relationship. It ranges between -1 and +1, with positive value (+1) indicating a perfect positive linear relationship between the variables and a

negative value (-1) indicating a perfect negative relationship between the variables. A value of 0 indicates that there is no relationship between the variables (Saunders et al, 2016).

In this research the researcher made use of the bivariate analysis on SPSS. These are a form of descriptive statistics that compares different variables simultaneously to determine whether a relationship exists between them, and if so, the nature of the relationship. The research used the Spearman rho coefficient to examine the association between the selected variables or Kendall's rank correlation coefficient. Spearman rho correlation coefficient measures the strength between categorical variables; it is nonparametric and does not require that data follows normal distribution. The rationale behind the use of Spearman rho correlation is its ability to work better with smaller sample sizes and that it is non-parametric. This means that it relies more on rankings and order (Wu, Geng and Zhao, 2017). Several variables were tested to gauge their influence on each other as shown in the analysis below.

Descriptive statistics includes the use of graphs, charts and tables etc. to represent and to provide a summary of data. It arranges an analytical description which allows for an expressive presentation of distributions and patterns that exist in the data (Mendenhall, Beaver and Beaver, 2013).

3.4. Limitations

The main limitation is that the study was limited to one stakeholder in the property industry, that is, the residential real estate SMEs operating in the inner property development space. The findings could be different if other stakeholders, such as the commercial banks and venture capitalist firms, were involved. The research reviewed the stringent requirements placed on SMEs in real estate development space by commercial banks in general. The researcher did not take into account the specific lending criteria of the different commercial banks in South Africa.

Other limitations included the following:

- Venture capitalist is fairly new in South Africa; hence there is not a lot of secondary data available.
- Time and resources are limited. Hence the sample size was not as large as the researcher anticipated, but the study captured a sample that is a true representation of

the population. This way the researcher believes consistent and valid findings were achieved.

- The survey strategy limited the respondents in giving an in depth detailed information because of the structured questions which only allowed for a limited response. Furthermore, the Likert scale chosen only allows the respondents to select a specific rating as their answer to the questions (e.g., agree, disagree).

3.5. Ethical considerations

All necessary steps were taken to ensure that there were no violation of any ethical standards. This safeguarded participants from any harm embarrassment or material disadvantage. The study posed an insignificant amount of risk, if any, to the participants. All participants were contacted and prior permission sought from them before either an email link for the online questionnaire or printed copies of the questionnaire were handed over to them. Both the methods used (i.e., email and printed copy of the questionnaire) included a cover page detailing the nature of the study, an explanation that the information given was going to be used for academic purposes only, the research problem, aims of the study, instructions on how to complete the questionnaire, that participation was voluntary, participants may pull out from the study at any time, completion of the questionnaire is the participants discretion and a completed questionnaire that was returned to the researcher automatically meant willingness to take part in the study.

The anonymity of the participants was guaranteed and all information collected were treated in the strictest confidence. This had a positive benefit to the study because the respondents felt free to express themselves more freely under the veil of anonymity. Hence the quality of the primary data was improved.

The literature used in the study is properly referenced. Intellectual property rights and privacy rights were respected at all times. There were no intentional misrepresentation of the findings of the research study and all data was reported accordingly in line with the requirements of the University of the Witwatersrand Johannesburg. .

Chapter Four: Results and Findings

4.0 Introduction

This chapter presents the main findings of the research. The findings are based on literature reviewed and the survey results obtained from the respondents. The survey was emailed to the residential real estate developers who are involved in the inner city rejuvenating space. These developers are the owners of their start-up companies. Descriptive statistics and correlation analysis were used to present the results. These results seeks to provide an understanding of whether venture capital and the TUHF can be alternative finance options (acquisition, property development and construction) for start-up inner city residential real estate developers instead of commercial bank finance.

4.1 Demographic characteristics

The respondents who formed part of the study demography represented in the research were distinguished by the following characteristics: The number of employees employed by the start-up developer, company description, number of years in operation, commercial bank finance and problems of accessing finance. This was designed to collect data of the respondents and their companies and this section reports on the descriptive analysis of these demographic characteristics.

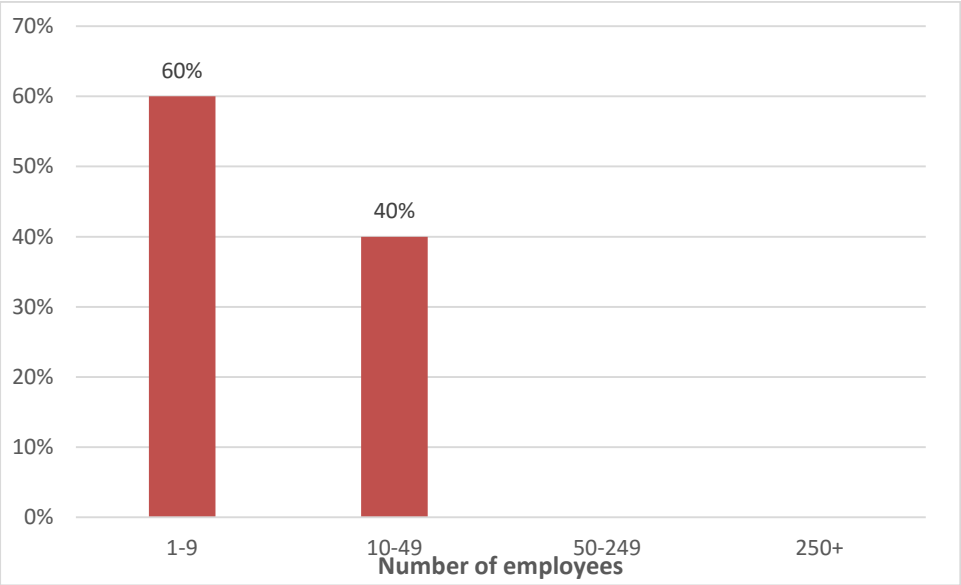
The respondents were SMEs operating in the inner city of Johannesburg's real estate environment. A total number of 45 questionnaires were distributed SMEs. The numbers of questionnaires completed and returned were 30 (i.e. 67 % response rate). This response rate was deemed to be a valid representation of the population.

4.1.1 Number of employees

In order to determine the number of employees of the respondents employed, the participants were asked to reveal how many people were hired by them. Figure 11 illustrates the number of employees the respondents hired as part of the human capital required to run the business. It can be noted that 60% which is a greater number of the real estate developers had 1-9 employees whilst the rest of had 40% between 10-49 employees. This affirms the assertion

by Fatoki and Asah (2011) that Small Medium Enterprises (SMEs) are a crucial vehicle that can be used in growing the economy to lower unemployment rate and alleviating poverty.

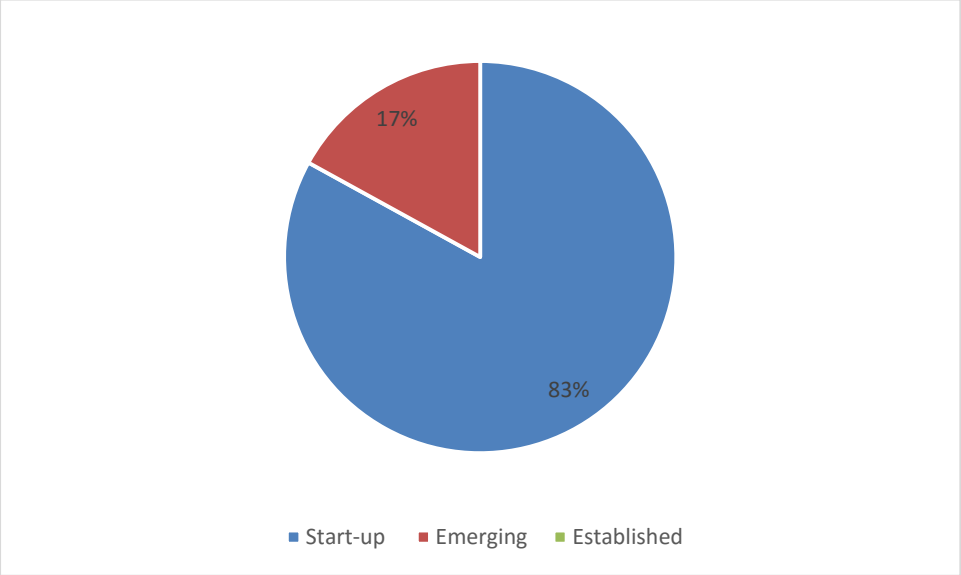
Figure 11: Number of employees employed



4.1.1.1 The description of the company

The question intended to understand the type of company the respondents own, whether it is a start-up, emerging or an established company. Figure 12 illustrates the company description that the respondents operate. It can be noted that a larger percentage which is about 83% are start-up inner city residential real estate developers, whilst the remaining 17% are emerging inner city residential real estate developers.

Figure 12: Company description



4.2 Correlation Analysis

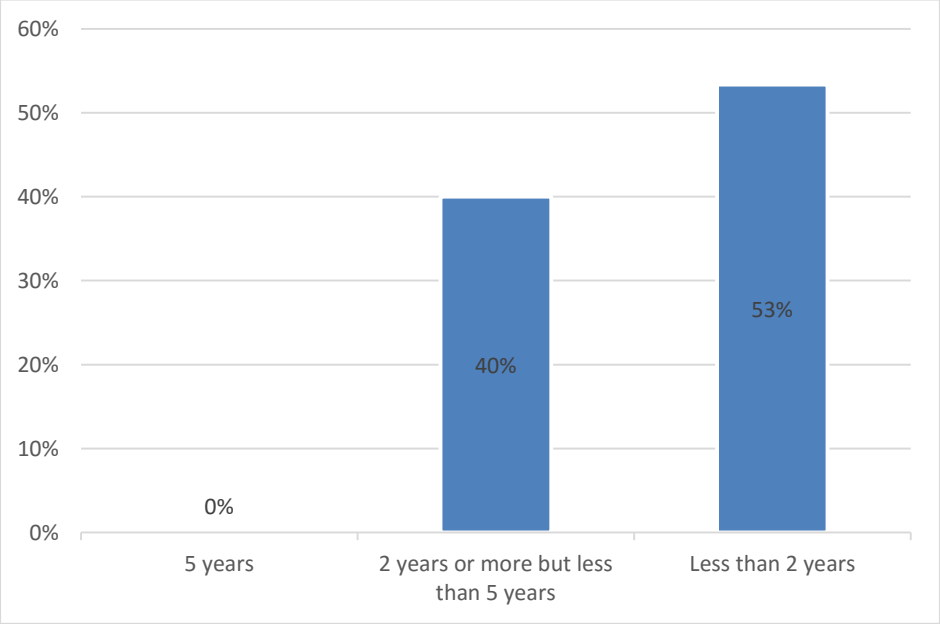
A correlation coefficient allowed the researcher to quantify the strength of a linear relationship between two ranked or numerical variables. Correlation coefficient is denoted by (r), which indicates the strength and direction of relationship. It ranges between -1 and +1, with positive value (+1) indicating a perfect positive linear relationship between the variables and a negative value (-1) indicating a perfect negative relationship between the variables. A value of 0 indicates that there is no relationship between the variables (Saunders et al, 2016).

The factors below are identified to have an influence on SMEs obtaining finance from commercial banks; the factors were tested through the questionnaire.

4.2.1 Number of years in operation

In order to determine the length of time in operation as a company, the respondents were asked to indicate the number of years that they have been working in property development industry. Figure 13 illustrates the number of years the respondents have been in business. It can be observed that 53% have been operating under two years. About 40% had been in operation over two years but less than five years and finally 0% had been operating for 5 years. 53% start-ups were still in danger of failing since an estimated 75% of SMEs failed within the first two years of operation due to inaccessibility of debt finance in South Africa (Fatoki and Odeyeni, 2010; Fatoki and Asah, 2011and Likotsi, 2015).

Figure 13: Number of years in operation



4.2.2 A company's track record influence on residential real estate developer's access to finance

The correlation coefficient tests whether a company's track record has a statistical relationship with inner city residential real estate start-up developers in accessing finance from commercial banks. Table 2 shows that the *p*-value = 0.477 which means that there is a positive relationship between a company's track record and access to finance from commercial banks. However, the relationship is extremely weak as it is far removed from 1 (r = 0.135). The test is statistically insignificant.

This finding is contrary to the literature reviewed, according to (Fatoki and Asah, 2011 and Liang, 2012) Only SMEs with good collateral have a good chance of obtaining commercial bank finance, because collateral is a major factor in deciding whether or not to finance SMEs. Therefore, a major obstacle for development and growth of firms as well as working capital is access to finance (Kasseeah,Ancharaz and Tandrayen-Ragoobur, 2013).

Due to this surprising results, the researcher further tested possible intervening variables that play a role in facilitating the relationship between track record and access to finance from commercial banks. A partial correlation analysis was conducted in SPSS. This involved conducting a correlation analysis between track record and access to finance from commercial banks for start-up inner city residential real estate developers.

The size of the company control variable was introduced to test its influence on track record and access to finance from commercial banks. It was observed in Table 2 below that when size of the company is considered in the correlation analysis, the correlation coefficient increases from 0.135 to 0.143 when an additional variable is added.

Another control variable was introduced, the number of years a residential real estate company was in operation in the test of the relationship between track record and access to finance from commercial banks. Table 4 shows that the correlation coefficient increases from 0.135 to 0.268.

Table 2: Spearman's rho correlations results

			Lack of track record barrier	Source of finance
Spearman's rho	Lack of track record barrier	Correlation Coefficient	1.000	.135
		Sig. (2-tailed)	.	.477
		N	30	30
	Source of finance	Correlation Coefficient	.135	1.000
		Sig. (2-tailed)	.477	.
		N	30	30

Table 3: Spearman's rho correlations results

Control Variables			Lack of track record barrier	Source of finance
Size of company barrier	Lack of track record barrier	Correlation	1.000	.143
		Significance (2-tailed)	.	.461
		Df	0	27
	Source of finance	Correlation	.143	1.000
		Significance (2-tailed)	.461	.
		Df	27	0

Table 4: Spearman's rho correlations results

Control Variables			Lack of track record barrier	Source of finance
Years in operation	Lack of track record barrier	Correlation	1.000	.268
		Significance (2-tailed)	.	.160
		Df	0	27
	Source of finance	Correlation	.268	1.000
		Significance (2-tailed)	.160	.
		Df	27	0

4.2.3 There is a direct link between lack of collateral and the persistent problem of access to finance faced by residential real estate developers.

The correlation coefficient test seeks to test whether the influence of lack of collateral acts as a barrier in accessing finance from commercial banks for the Johannesburg inner city residential real estate property developers. Table 5 shows that the r value is 0.232, which means there is positive relationship. However, the relationship is weak, as it is significantly distant from 1. The relationship is statistically insignificant.

These results suggest that there is insufficient information to conclude that the influence of lack of collateral has a slightly positive relationship with the problem of accessing finance from commercial banks by developers. This result is unexpected since track record presents a problem for real estate development start-ups because they do not have a reliable credit history of servicing their developmental loans hence there high chances of rejection as cited

by (Liang, 2012; Owusu-Manu et al., 2015). Therefore, the researcher expected the relationship between access to finance and track-record to be very strong and statistically significant.

Table 5: Spearman's rho Correlations results

			Problem accessing finance	Lack of collateral barrier
Spearman's rho	Problem accessing finance	Correlation Coefficient	1.000	.232
		Sig. (2-tailed)	.	.218
		N	30	30
	Lack of collateral barrier	Correlation Coefficient	.232	1.000
		Sig. (2-tailed)	.218	.
		N	30	30

4.2.4 The age of a residential real estate development company has a negative relationship on the number of years the company has been operational

The correlation coefficient seeks to test whether the age of a residential real estate development company has a statistical relationship on the length of time the company has been operational. Table 6 shows that the r = 0.092, which means the relationship is positive. However, the relationship is weak, as it is significantly distant from 1. The effect is statistically insignificant. We can therefore conclude that there is no relationship between the age of the company and the length of time the company has been operational. But age of the company is a factor in deciding to lend money to start-ups (Owusu-Manu et al., 2015).

Table 6: Spearman's rho correlations results

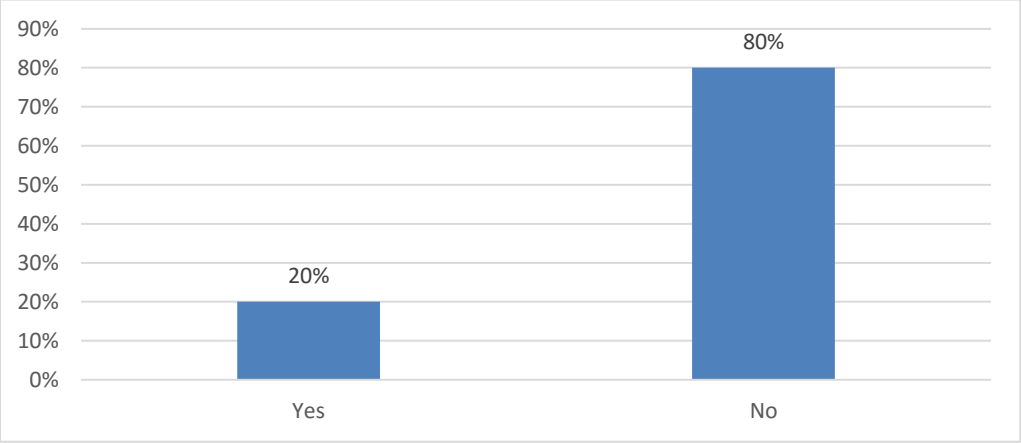
			Age of company barrier	Years in operation
Spearman's rho	Age of company barrier	Correlation Coefficient	1.000	.092
		Sig. (2-tailed)	.	.628
		N	30	30
	Years in operation	Correlation Coefficient	.092	1.000
		Sig. (2-tailed)	.628	.
		N	30	30

The following section sought to find out the challenges faced by SMEs in financing their development endeavours and which phase of development carries a lot of risk in the development process for inner city residential real estate developers.

4.2.5 Dependence on commercial bank finance

This question seeks to find out how many of the respondents rely on commercial banks for financing their companies. Figure 14 illustrates the percentage of the respondents that are reliant on commercial bank finance and those that use alternative sources to finance their businesses. It can be observed that 20% have used bank finance. About 80% are not using bank finance.

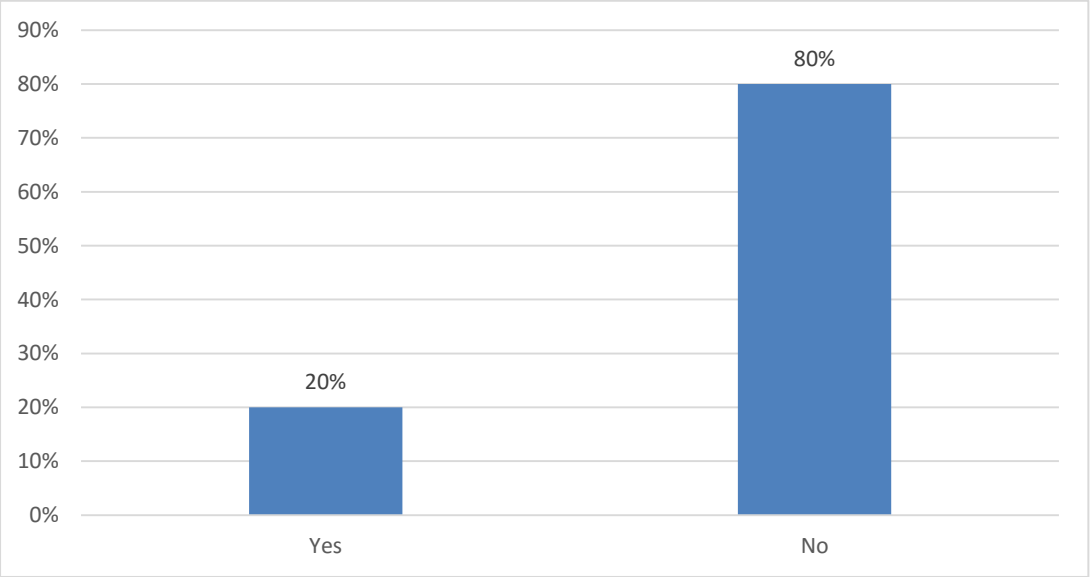
Figure 14: Commercial bank finance



4.2.6 Problem of access to finance

This question sought to find out if presently access to finance is the most persistent problem faced by the respondents. Figure 15 gauges the access to finance problem faced by the respondents profiled in the research. The results show that 20% of the respondents battle with accessing finance as opposed to the 80% who do not regard access to finance as a problem in their companies. However, the 80% is made up of start-up developers who took out mortgages or used an alternative source of finance to realise their development dreams instead of a development loan from the commercial bank loan.

Figure 15: Problems accessing finance



4.2.7 Acquisition, property development and construction finance is accessible at TUHF for residential real estate developers as opposed to commercial banks

The correlation coefficient tests whether acquisition, property development and construction finance is accessible at TUHF for inner city residential real estate start-up developers compared to commercial banks. Table 7 shows that no results could be obtained, there were not enough entries to calculate meaningful correlation analysis. However, according to the TUHF jobs case study, 2017 access to debt capital is considered a major stumbling block or constraint for growth by TUHF. Hence, the lending at TUHF is based on a project's feasibility and not the applicant's balance sheet and the loan term is 15 years which is longer than the industry norm of 10 years.

Table 7: Spearman's rho Correlations results

			Financing accessible at TUHF	Apply for bank loan
Spearman's rho	Financing accessible at TUHF	Correlation Coefficient	.	.
		Sig. (2-tailed)	.	.
		N	8	8
	Apply for bank loan	Correlation Coefficient	.	1.000
		Sig. (2-tailed)	.	.
		N	8	30

4.2.8 Start-up residential developers do not apply for commercial bank finance because of the fear of rejection

The correlation coefficient tests whether the company's description or type (for example, if the company is a start-up or emerging) has an influence in whether or not they choose to apply for a bank loan because of fear of rejection. Table 8 shows that the r = -0.186 therefore,

the relationship is a very weak and negative. It is statistically insignificant. This is supported by the assertion that an estimated 75% of SMEs fail within the first two years of operation due to inaccessibility of debt finance in South Africa (Fatoki and Odeyeni, 2010; Fatoki and Asah, 2011 and Likotsi, 2015).

Table 8: Spearman's rho Correlations results

			Apply for bank loan	Company description
Spearman's rho	Apply for bank loan	Correlation Coefficient	1.000	-.186
		Sig. (2-tailed)	.	.324
		N	30	30
	Company description	Correlation Coefficient	-.186	1.000
		Sig. (2-tailed)	.324	.
		N	30	30

4.2.9 The construction phase has a positive relationship on developers depending on commercial bank finance

The correlation coefficient seeks to test whether the construction phase has a positive relationship with residential real estate development companies depending on commercial bank finance. Table 9 shows that the r = 0.108 which means there is a positive relationship. However, the relationship is weak, as it is significantly distant from 1. The effect is statistically significant we can therefore conclude that there is a weak relationship between the construction phase and residential real estate company depending on commercial banks for finance. But, according to literature the construction phase has the highest financial risks; it is associated with cost overruns, time delays and project management risk. If this risk is not mitigated correctly the development may fail (Dullisear, 2001; Newell and Steglick, 2006). Therefore, the researcher expected to observe a strong relationship between the construction phase and access to finance.

Table 9: Spearman's rho Correlations results

			Construction phase	Commercial bank finance
Spearman's rho	Construction phase	Correlation Coefficient	1.000	.108
		Sig. (2-tailed)	.	.569
		N	30	30
	Commercial bank finance	Correlation Coefficient	.108	1.000
		Sig. (2-tailed)	.569	.
		N	30	30

This section tested whether Venture Capital of the Trust for Urban Housing Finance can be a funding option for real estate start-ups in the inner City of Johannesburg to finance residential real estate development.

4.2.10 The Trust for Urban Housing Finance (TUHF) is a better alternative source of finance for residential real estate developers compared to commercial banks.

The correlation coefficient tests whether there is a relationship between TUHF being a better alternative source of finance for inner city residential real estate start-up developers compared to commercial banks. Table 10 shows that no results could be obtained between the two variables. Therefore, no relationship exists between the variables. But, almost all the respondents were open to consider TUHF as an alternative source of finance.

According to TUHF Job Fund Case Study (2017), TUHF lends to individuals who show entrepreneurship and business potential. These individuals do not meet the traditional criteria for accessing debt capital. Therefore, TUHF captures this segment of the market and lends a lifeline. The researcher expected a strong relationship between TUHF being a better alternative source of finance compared to commercial banks.

Table 10: Kendall's tau_b Correlations results

			TUHF as alternative source of funding	Source of finance
Kendall's tau_b	TUHF as alternative source of funding	Correlation Coefficient	.	.
		Sig. (2-tailed)	.	.
		N	30	30
	Source of finance	Correlation Coefficient	.	1.000
		Sig. (2-tailed)	.	.
		N	30	30

4.2.11 Venture capital is a better source of finance for residential real estate developers compared to commercial banks

The correlation coefficient tests whether venture capital is a better alternative source of finance for inner city residential real estate start-up developers compared to commercial banks. Table 1 1shows that the r = -0.148 therefore, there is negative relationship between venture capital being a better alternative source of finance compared to commercial banks and it is statistically insignificant (p = 0.435). This result is not surprising since venture capitalist do not invest in all sectors equally, but select specific industries. Venture capital largely funds industries such as software and biotechnology and excludes industries such as hotel and lodging (Lee and Wahal, 2004). Venture capitalist pursue technological inclined industries because they are more likely to succeed compared to other sectors in the general economy (Zacharakis, 2007).

The researcher introduced the respondents who applied for commercial bank financing as a control variable to test if there is an intervening variable that play a role in the relationship between venture capital finance being an alternative source of finance to commercial banks. Further analysis was accomplished through partial correlation analysis in SPSS. This involved conducting a correlation analysis between venture capital, commercial finance and

the respondents who applied for funding at the bank. It can be observed in the Table 12 below that the correlation coefficient increases from -0.148 to -0.123 when a control variable is added.

Table 11: Spearman's rho Correlations results

			Venture capital source of finance	Source of finance
Spearman's rho	Venture capital source of finance	Correlation Coefficient	1.000	-.148
		Sig. (2-tailed)	.	.435
		N	30	30
	Source of finance	Correlation Coefficient	-.148	1.000
		Sig. (2-tailed)	.435	.
		N	30	30

Table 12: Spearman's rho correlations results

Control Variables			Venture capital source of finance	Source of finance
If applied for commercial finance	Venture capital source of finance	Correlation	1.000	-.123
		Significance (2-tailed)	.	.627
		Df	0	16
	Source of finance	Correlation	-.123	1.000
		Significance (2-tailed)	.627	.
		Df	16	0

4.3 Chapter Summary

This chapter has outlined the findings of the research. Key results of the chapter are as follows:

- The overall questionnaires completed by the respondents and analysed were 30 which was deemed satisfactory.
- Most of the companies that participated were the targeted companies which are start-up residential real estate developers operating in the inner city of Johannesburg.
- It was observed that 20% of the respondent s have used bank finance and 80% are not using bank finance
- The respondents who battle to access finance are around 20% and the 80% do not regard access to finance as persistent problem in their companies. However, the 80% is made up of start-up developers who took out mortgages or used an alternative source of finance to realise their development dreams instead of a development loan from the commercial bank.
- The correlation coefficient tests whether a company's track record has an influence in Inner city residential real estate start-up developers in accessing finance from commercial banks revealed that the relationship is very weak and statistically insignificant which is a departure to the literature reviewed. .
- The correlation coefficient tests whether there is a relationship between TUHF being a better alternative source of finance for inner city residential real estate start-up developers compared to commercial banks. There were no results for this test therefore the conclusion was there is no relationship between the variables. But, almost all the respondents were open to consider TUHF as an alternative source of finance.
- The correlation coefficient tests whether venture capital is a better alternative source of finance for inner city residential real estate start-up developers compared to commercial banks. The results show a negative relationship which is weak and insignificant.
- The Correlation coefficient tested whether the influence of lack of collateral acts as a barrier in accessing finance from commercial banks for the Johannesburg inner city residential real estate property developers. The results show a weak positive relationship and it is statistically insignificant.

- The correlation coefficient tested whether acquisition, property development and construction finance is accessible at TUHF for inner city residential real estate start-up developers compared to commercial banks. No results could be obtained; there were not enough entries to calculate meaningful correlation analysis.
- The correlation coefficient tested whether the construction phase has a positive relationship with residential real estate development companies and dependence on commercial bank finance for their development endeavours. There was a weak positive relationship and the effect was statistically insignificant.

Chapter Five: Conclusions and Recommendations

5.0 Introduction

This chapter focuses on the objectives of the research and development of the previous chapters, key findings are summarised and related to the problem statement put forward by the researcher. Moreover, recommendations and suggestions for further research on the subject of the challenges of access to finance by inner city residential real estate developers.

5.1 Summary

The research aimed to develop a better understanding of the barriers to finance placed by commercial banks on SMEs operating in inner city residential real estate development in Johannesburg, South Africa. These barriers to finance have prevented inner city real estate developers from accessing finance. It further sought to explore if venture capital or the Trust for Urban Housing Finance can be a viable option to fun d start-up residential real estate developers operating in the inner city space.

5.1.1 Identifying the factors that influence funding for start-up residential real estate developers from commercial banks.

Review of literature revealed that there are factors that prevent SMES from accessing finance, such as lack of collateral, a company's track record, and age of company among others. The findings are contrary to the literature reviewed, lack of collateral showed a weak positive relationship to access to finance and it was statistically insignificant.

The correlation coefficient tests whether a company's track record has an influence in Inner city residential real estate start-up developers in accessing finance from commercial banks revealed that the relationship is very weak and statistically insignificant which is a departure to the literature reviewed.

5.1.2 To examine the challenges faced by start-up real estate development SMEs operating in the inner city of Johannesburg in obtaining finance and the real estate development phase that carries the most financial risk.

The literature explored the option available for financing a development, such as pension funds, insurance companies, life assurance companies, investment trust, commercial banks and government assistance, joint ventures and mortgages, TUHF and external equity investors. The results revealed that the most used financial structure by the real estate start-up developers to fund their development endeavours was mortgages.

The results show that 20% of the respondents battle with accessing finance as opposed to the 80% who do not regard access to finance as a problem in their companies. However, the 80% is made up of start-up developers who took out mortgages or used an alternative source of finance to realise their development dreams instead of a development loan from the commercial bank loan.

The phases of property development and risk associated with each phase was undertaken. The literature showed that the phase that carries more financial risk in the development process is the construction phase. The findings show that there is a positive relationship between access to finance from commercial banks and the construction phase, although it was found to be weak as per the Spearman's correlation results.

5.1.3 To evaluate whether or not Venture capital or the Trust for Urban Housing Finance can be and option for real estate start-ups in the inner city of Johannesburg to finance residential real estate development

The research also explored the option of using venture capital to fund start-up residential real estate developments. The literature revealed that most venture capitalist invest in high risk, high reward industries such as software and biotechnology. The research found that the relationship between venture capital and access to finance from commercial banks is negative and is overall insignificant.

The Trust for Urban finance was also considered as an option for financing start-up residential real estate developers for the inner city of Johannesburg. The reason for choosing TUHF is because inner city regeneration is their niche market. TUHF fund individuals from

all walks of life who are interested in developing residential units in the inner city. The TUHF financing model's criteria for funding is the profitability of the development project. Hence, collateral, track record, age of the company, etc. does not play a role for the TUHF to finance a start-up developer.

The findings show that the relationship between the TUHF being a better alternative source of finance to commercial banks is non-existent. Furthermore, the correlation co-efficient test for testing whether acquisition, property development and construction finance is accessible at TUHF for the inner city residential real estate start-up developers compared to commercial banks, no results could be obtained because there were not enough entries to calculate a meaningful correlation analysis.

But, a lot of the respondents were open to consider the TUHF as an alternative source of finance. The reason for the negative results is because the TUHF start-up developers, most of them did not complete and return the survey questionnaire.

5.1.4 Research Question: The research question analysis

Why South African banks are reluctant to offer acquisition, development and construction finance to start-up residential real estate developers in the inner city of Johannesburg? And, can venture capital and or The Trust for Urban Housing Finance be considered as an option?

In attempting to answer the research question, the researcher looked at the barriers of accessing finance from the commercial banks, such as need for track record, collateral and age of the company. However, the findings show that there is a weak relationship between track record and access to finance which is contrary to the literature reviewed. The relationship between lack of collateral and access to finance from commercial banks is a weak positive and is deemed statistically insignificant. This finding is a departure from the literature reviewed because banks are very strict on collateral and track record as part of their decision for granting loans. The correlation coefficient test on whether acquisition, property development and construction finance is accessible at the TUHF yielded no results because there were not enough entries to calculate a meaningful correlation analysis.

Finally, these results are contrary to the expectation of the researcher and the literature reviewed. Track record and collateral has a major influence on access to finance from

commercial banks. The TUHF as an alternative source of finance had no results because the TUHF start-up inner city residential real estate developers did not participate in large numbers. Venture capital as an alternative source of finance was very weak and insignificant relationship hence venture capital cannot be seen as an alternative source of finance from commercial banks.

5.2 Recommendations for further research

The research focused on the SMEs perspective. The area of the research that requires further research and observation of the financing gap problem is the commercial bank perspective.

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