

private sector led venture that will mobilise more than R1 billion in home loans for low-income families." This, the statement said, will be enough to house no less than 250 000 people in 40 000 homes. In terms of the scheme, a further R2 billion could be made available by banks and building societies, the statement said. This new package boils down to a highly complex and sophisticated set of techniques that will enable the financial institutions to give loans to low-income homeowners without reducing their profit margins or increasing their risk. Instead, these new techniques will transfer the costs of risk and profit security onto the individual homeowner. (Swilling; 1990). This is how it will be done.

5.2.1 Background

To date, banks and building societies have refused to provide loans for less than R35 000. This meant that at least 90% of South Africa's black population could not get housing loans because they earned less than the R800 a month minimum demanded by financial institutions to qualify for these R35 000 loans. In terms of this new scheme, loans of between R35 000 and R12 500 can be provided. This, the UF estimates, will make it possible for the top 40% of those who require housing to get a loan. How has this been made possible?

5.2.2 Housing Financial Institutions Down Market

Financial institutions are reluctant to move down market for 2 major reasons:

- i) the perceived risk
- ii) low profitability

The Loan Guarantee Initiative is in essence a method for removing these two obstacles.

i) Addressing the risk factor

Risk is perceived by the financial institutions at the level of default. It is assumed that there is a greater chance of poor people failing to meet their commitments than is the case with rich people. This has been statistically proved to be untrue in other parts of the world. In fact the risk of a loss on foreclosure on small loans, where demand is highest, is significantly lower than in the middle and upper income groups where supply and demand are more closely aligned. (Finance Week; 12/10/1989; 51).

Traditionally, banks and building societies have provided home loans equal to between 80% and 95% of the property valuation. To reduce their risk in the small loans sector, the banks and building societies want to limit their exposure to 60% of the value of the property. This will be possible through the provision of insurance guarantees.

Two forms of insurance guarantees will be available:

- a) a compulsory policy equal to 20% of the value of the property. This will enable the bank and building society to issue 80-95% bonds with a guarantee that in the event of non-payment by the homeowner, 20% of the value of the bond will be paid to the banks and building societies by the insurance company. This is how the "exposure" of these institutions is reduced.
- b) an optional policy equal to 15% of the value of the property. This policy can be taken out by those who cannot afford the 20% deposit normally required by banks and building societies. This policy will enable these people to pay a 5% deposit without putting the bank and building society at risk; ie the bank and building society will still, in effect, have a guaranteed 20%

deposit - 5% in cash from the home buyer and 20% from the insurance companies in the event of non-payment and repossession. The home buyer, in turn, will be paying off a 95% bond.

The insurance companies would not have put up these insurance policies if they, in turn, did not have their own guarantees. This is where the Loan Guarantee Fund comes in. The Fund, at the moment, has R20 million. This money has come from direct contributions from the British government, German Government, Swiss Government, BP South Africa, Caltex Oil, Japan South Africa Fund, Toyota, Anglo-American, Anglovaal, Barlow Rand, First National Bank, Gencor, Liberty Life, Nedcor, Rembrandt, Sanlam, Southern Life, Standard Bank, Tongaat-Hulett, United Building Society, Nedperm Bank, Saambou, Santambank, Standard Bank and Volkskas. (Swilling; 1990).

The Loan Guarantee Fund will provide a first loss insurance policy for the insurance companies who provide the policies to the banks and building societies referred to above.

The Loan Guarantee Fund was necessary, firstly, to convince the insurance companies to come into the deal; and secondly, to reduce their exposure (risk) so that they would be prepared to allow a low premium on the two policies.

In short, the "risk factor" is dealt with by providing insurance guarantees for the banks and building societies and then providing, in turn, guarantees for the insurance companies via the Loan Guarantee Fund.

It must be noted that the premiums for all these insurance guarantees are paid by the home buyer. In other words, to get a loan for less than R35 000, the home buyer must pay the premiums for the compulsory 20% insurance policy and the optional 15% deposit insurance. These costs are not carried in any way by any

of the financial institutions or the Loan Guarantee Fund (or the state, for that matter).

ii) Addressing the non-profitability of small loans

So called "small-loans" are not profitable for the banks and building societies. The reason is that financial institutions incur a certain fixed administration cost, irrespective of the size of the loan, but smaller loans simply generate less income. (Planning 107; 1990; 92)

The LGI scheme, however, has devised a way of resolving the profitability from small loans problem. There are three issues at stake:

- a) collateral and the deposit;
- b) administrative costs;
- c) the limits on how much a bank or building society can lend.

a) COLLATERAL AND THE DEPOSIT

In the past, to get a home loan, the home buyer had to put up a deposit equal to 20% of the value of the property. The loan was therefore equal to 80% of the property value. The bank and building societies made their profit out of the interest on 80% of the value of the property.

In the new scheme, banks and building societies have agreed to provide 95% bonds on condition there is a 15% insurance policy payable to them (as discussed above). The mechanism however, does not only resolve the "risk" factor, it also partially resolves the profitability factor, in that bank and building societies will now make their profit out of a 95% loan instead of an 80% loan. This, in turn, comes with a guarantee that they will be covered by 2 policies (totalling 35% of the value of the

property) in the event of non-payment and repossession. In short, collateral is no longer primarily a cash deposit, it has been turned into an additional source of profit (ie it has been commercialised).

b) ADMINISTRATIVE COSTS

The Usury Act regulates what charges and costs the banks and building societies can build into any given loan (ie what charges they are entitled to make the home buyer pay, and what charges should be carried by the banks and building societies). The Usury Act has recently been amended to include 3 new charges:

- (a) an "initiation fee" of R175.00 that will go to cover the costs of approving and initiating the loan;
- (b) "security variation fee" of R100.00 which will go towards covering the costs incurred by the banks and building societies when employees change jobs, ie it costs money to change the documentation to reflect the new employer's names who stand security for the bond;
- (c) a "monthly ledger fee" of R5 to cover general expenses.

In short, an additional R280.00 will be built into the loan. This, the UF argues, must be measured against the fact that the "valuation fee" - an existing charge that has always been built into the loan - has been simultaneously reduced from R250.00 to R100.00. Nevertheless, this means that there is a wider range of charges that can be increased in future.

c) LIMITATIONS ON LENDING

In terms of the Banks Act, banks and building societies has to hold capital to a specified amount for the assets it has on its balance sheet (Finance Week; October 12; 1989; 51). This of course places a constraint on the amount they are able to lend out.

The Reserve Bank has now agreed to a new and special class of capital to be created for the financial institutions participating in the loan guarantee initiative, which increases their ability to lend and in a manner which is not competitive with other lending opportunities not destined for low income housing, (Planning 107; 1990; 92). This is how it will be done.

The financial system is such that it is possible to create capital without acquiring more fixed assets or investments. Banks and building societies will be able to draw down on this special class of capital provided in the form of compulsory convertible, 10 year, market related variable rate, debentures. It will be a debenture because it will be tax deductible and convertible to a preference share by virtue of its status as second tier capital.

In summary, then by (a) turning the deposit into a source of profit; (b) transferring administration costs to the home buyer; and (c) issuing special loans against a new class of capital, the "profitability factor" has been removed as an obstacle in the way of providing loans of below R35 000.00.

This whole scheme has been praised by finance capital, because it opens up a new market segment. (An estimated 30% of black households who could participate in the private sector housing market - did do so due to bond rates being out of reach. (PACE, December/January 1990; 145)). This is done without increasing the risk or reducing the profit margins of financial institutions.

In addition, the UF would like the trade unions to direct the major pension and provident funds to buy the debentures. (Discussed below) By doing so, it is argued, the unions will be making a direct investment in worker's housing while simultaneously investing pension or provident fund money at market rates.

5.2.3 Evaluation of Loan Guarantee Initiative

FINANCIAL VIABILITY

The Urban Foundation believes (Planning 107; 1990;92) the substantial market depth will insure the success and sustainability of the scheme. No re-insurance has however been sought internationally. The hope is that in the long term supply and demand will create normal market conditions.

SOCIALLY EQUITABLE

As Matthew Nell of the Urban Foundation rightly stated, this initiative only addresses part of the housing finance problem in that it caters for the top 45% of urban households. It does not address the needs of the bottom 55% who require shelter. Nor does it address the needs of rural families. (Finance Week; October 12-18; 1989; 49). (It is these poor people who are the concern of this paper).

5.3 PENSION/PROVIDENT FUNDS

The primary objective of the scheme is to increase the affordability of homes to members of a pension - or provident fund, as part of their total retirement package.

The underlying principles of the scheme include the following:

- The advantages to those members partaking in the scheme must not diminish the benefits of other members.
- A participant must eventually be in the same position as a non-participant.
- Loans from the fund to members must be insured.
- These pension funds could serve as security for a 5% deposit on a loan. Members could then qualify for a 95% bond from a financial institution.

It is usually expected that a borrower pay 25% of his salary on a loan. According to this scheme the initial deficits on monthly payments will be met by advances from the pension and provident funds in the form of an additional loan.

As the member's salary increases, they will eventually be able to pay the full monthly bond repayments. When the bond is repayed, the member could start repaying the loan to the pension fund (5% deposit plus initial deficits on payments) before retirement age.

This scheme would require some legal amendments, because legislatively on 25% of a provident fund can be made in loans. The majority of members would then be excluded by this restriction. (Business Day 17/01/1990; 15).

Another proposal by the UF on the way in which pension and provident funds could be used, is by buying debentures. The major proportion of pension and provident funds go into the stock market but life offices who look after the interest of their policy and pension holders are reluctant to invest in housing because it will provide a lower return (Business Day; 17/01/1990).

5.3.1 Evaluation of Pension/Provident Fund Proposal

SOCIALLY EQUITABLE

This solution of using pension funds as collateral behind home mortgages, of course depends on the potential home-buyer having the good fortune of holding a secure job, with a fair-sized pay packet and with a sound retirement fund behind him in the first place (The Star; 9/04/1990; 9).

Therefore although this scheme is a praiseworthy attempt to unlock the billions of investment funds for low-income housing, it is not socially equitable. It does not address the plight of two-thirds of the black population who cannot afford to even raise a deposit for a house, let alone meeting the minimum monthly bond repayment requirements needed to buy a formal conventional home.

FINANCIAL VIABILITY

Firstly, it is doubtful whether fund managers will break out of their traditional conservatism and use the pension funds to provide loan guarantees to members.

Secondly, trade unions are objecting to the use of workers' money in pension and provident funds to subsidise housing needs. Numsa, for example believes that the state and employers should subsidise housing. They expressed that they will not negotiate further on individual housing loans from any particular pension and provident fund until such time when a housing allowance from employers has been agreed to. (Business Day; 17/01/1990; 9).

Before at least these two constraints are addressed adequately, pension and provident funds will continue to find their way onto the stock exchange while squatter settlements mushroom and overcrowding reaches intolerable levels.

5.4 THE GROUP CREDIT COMPANY

5.4.1 Introduction

The problem of finance is the most critical in the informal, shelter market, which doesn't lend itself to traditional mortgage finance:- meaning an identified product to be completed in an identified time at an identified price. Jorgenson (1982;) identified the following peculiar characteristics of shelter finance. People in need of shelter require:

- loans to purchase stands only
- loans to purchase building materials
- loans to pay for building assistance
- deposits on formal houses for conventional mortgage bond finance.

Characteristically, the loans required are small, and they are required to finance unknown products due to the incremental nature of shelter procurement. Their home improvements and upgrading initiatives will also require financing.

The Urban foundation proposed a small loans company as the institutional framework within which such loans could take place.

5.4.2 Description of Small Loans Company and its Operations

The Group Credit Company (GCC) can be described as an apex organisation formed to provide support and finance to savings clubs advancing housing and home improvement loans to their members, ie lower income households.

The aim is to develop a mechanism for providing finance for housing and home improvement to lower income households which currently do not have access to conventional sources of finance.

The Urban Foundation had launched this pilot company in the Western Cape. Its feasibility depends on the fact that it is acceptable to all stake-holders and that it is financially viable.

The Group Credit Company is in essence an attempt to integrate existing financial institutions and non-institutional money markets (savings and credit unions). Jorgenson (1982) identified this non-institutional shelter finance system as the most characteristic form of finance used by the poor to construct shelter.

The short term objectives of the pilot scheme is to test and evaluate:

- under working conditions, the principles and viability of the Borrower as a mechanism for providing housing and home improvement finance by identifying, observing and analysing the factors perceived to influence its performance
- the influence of the high risk components, ie public perception and acceptance, on the Borrower's viability
- the adequacy of the corporate structure and operating procedures for the collection of loan service instalments, the type of security required and available, and the handling of defaults
- the viability of the approach to involve community organisations at a grass roots level as a means of channeling housing finance.

5.4.3 Loan Products/Interest/Security/Group Pressure

- Loan amounts are available in multiples of R500 (with a minimum of R500 and a maximum of R5 000) and loan periods will vary from one to five years.
- Interest rates are set at the maximum permissible in terms of the Usury act, ie 31%. Repayments will be on a fixed monthly instalment basis.
- Security for loans will be in the form of a 10% deposit placed by the savings club with a financial institution to the Group Credit Company. A legal document of debt acknowledgment would also be signed by the stokvel.
- Measures to build group pressure includes:
 - a) the deposit, constituting of members' collective savings
 - b) a credit limit to each group, of which the savings club decide the basis of allocation
 - c) Public repayments are made at monthly meetings in the presence of elected group representatives. A carefully constructed, step-by-step, default management programme is followed.

(DBSA project appraisal - Small Loan Company)

5.4.4 Evaluation of Group Credit Company

SOCIALLY EQUITABLE

The success of the pilot scheme is dependent on it's acceptability in the lower income community. An assessment of

its social equitability would have to include client profile. The following is the status at the end of June:

- . Number of groups = 30
- . Number of members = 469 people
- . Average group size = 15.6 people
- . Average age of members = 43 years
- . Sexual composition: Male = 31%
Female = 69% (an increase in number of domestic workers)

. Average monthly income per member = R467

. Of loans advanced:

- 14,5% to people earning R200 and under
- 59,5% to people earning between R200 and R600
- 26% to people earning more than R600

. The occupational profile shows that:

- 21,5% of members are self-employed
- 31% of members are domestic aids
- 9% of members are labourers

The remainder are in semi-skilled jobs.

. It appears from interaction with recent groups that approximately 60% to 70% of members have opened up their first savings account in order to participate in the scheme. (Group Credit Company monthly report of May and June 1990).

The Group Credit Company is therefore socially equitable in the sense that it is accessible to all low-income households and it is accepted in this target market.

ECONOMICALLY VIABLE

The aim is for the Group Credit Company to become a financially viable entity. At the moment it appears to be doing so, but the company's management now believe that the true testing of the project could not be achieved on the present scale of operations. A planned increase in the scale of lending is required in order to adequately test key financial viability assumptions impacting on the sustainability of the company, which would otherwise have remained untested at the current maximum R1,5 m loan book level. The urgency of developing a lending agency to service this market segment relates to the rapidly changing political climate and the distinct availability of development finance (Group Credit Company discussion document).

To give effect to this plan, the company proposes to:

- Procure a grant to absorb the current accumulated deficit
- Establish a capital reserve
- Repay its bridging loan to the UF
- Substitute its current R1,5m DBSA loan with guarantees
- Mobilise borrowing to fund its loan book.

Issues concerning alternative equity and funding structures, levels of funding, sources of finance, financing mechanisms and their associated cost, available to the company are still under consideration and negotiation.

It appears that the new plan would involve a total funding requirement of R20 million. The company's management however contends that the current financial position of the company, the perceived risk profile and the very limited track record, would not enable borrowings on a commercial basis to be effected without substantial financial support (grants/guarantees). The Group Credit Company's preliminary soundings from financial institutions indicate that such financial support would initially

need to equal 80% of borrowings. DBSA and the Independent Development Trust (IDT) have agreed to provide this guarantee.

It appears furthermore that the Company will always be reliant on soft loans and/or guarantees, if it is committed to growth in its debtors book. The Company is not considering direct Public Finance, (DBSA and IDT could be regarded as such) because they argue that their aim is to become self-sustainable and therefore they must look to the Private Sector for investment.

5.5 SUBSIDY PROPOSALS

The Urban Foundation's proposed housing subsidy policy comprises two components - a set of guiding principles and specific subsidy schemes. The broad social objective of provision of shelter for all is accepted as point of departure.

The proposed guiding principles are:

- i) Subsidy schemes should encourage private sector involvement in housing provision and limit the public sector's role to facilitating the private sector and providing for welfare cases.
- ii) They should reflect the socio-economic reality of our developing society, where the resources of government are limited and a significant proportion of the community have very low incomes.
- iii) The schemes should redistribute resources to less-advantaged households.
- iv) They should stimulate the supply of housing and not the demand for space and quality.

- v) They should be sustainable as a long-term national programme.
- vi) The subsidy schemes should allow for fair allocations.
- vii) They should be easy and economic to administer.

The proposals with respect to specific schemes are as follows:

- * The 90% loan scheme. No further loans should be offered. A modified First-time Home-Buyer's Scheme and a redirected SA Housing Trust scheme will meet the needs of this market.
- * Development loans to local authorities, welfare organisations and utility companies. Sufficient funds should be allocated so that projects already initiated can be completed, but no further applications should be accepted.
- * State-assisted Home-Ownership Savings Scheme. No further accounts should be opened.
- * Family housing scheme. Since this scheme is well entrenched it would prove difficult to terminate. It should therefore be phased out over time. This would be consistent with proposals to phase out parliamentary appropriations to the Housing Commissions.
- * Serviced sites. The current scheme should be modified and based on a capital subsidy on the selling price of the serviced site. There will be different categories of site according to levels of service. However, the capital subsidy amount should be the same across all categories. If not, those who can afford a higher level of service will appropriate sites developed for poorer

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