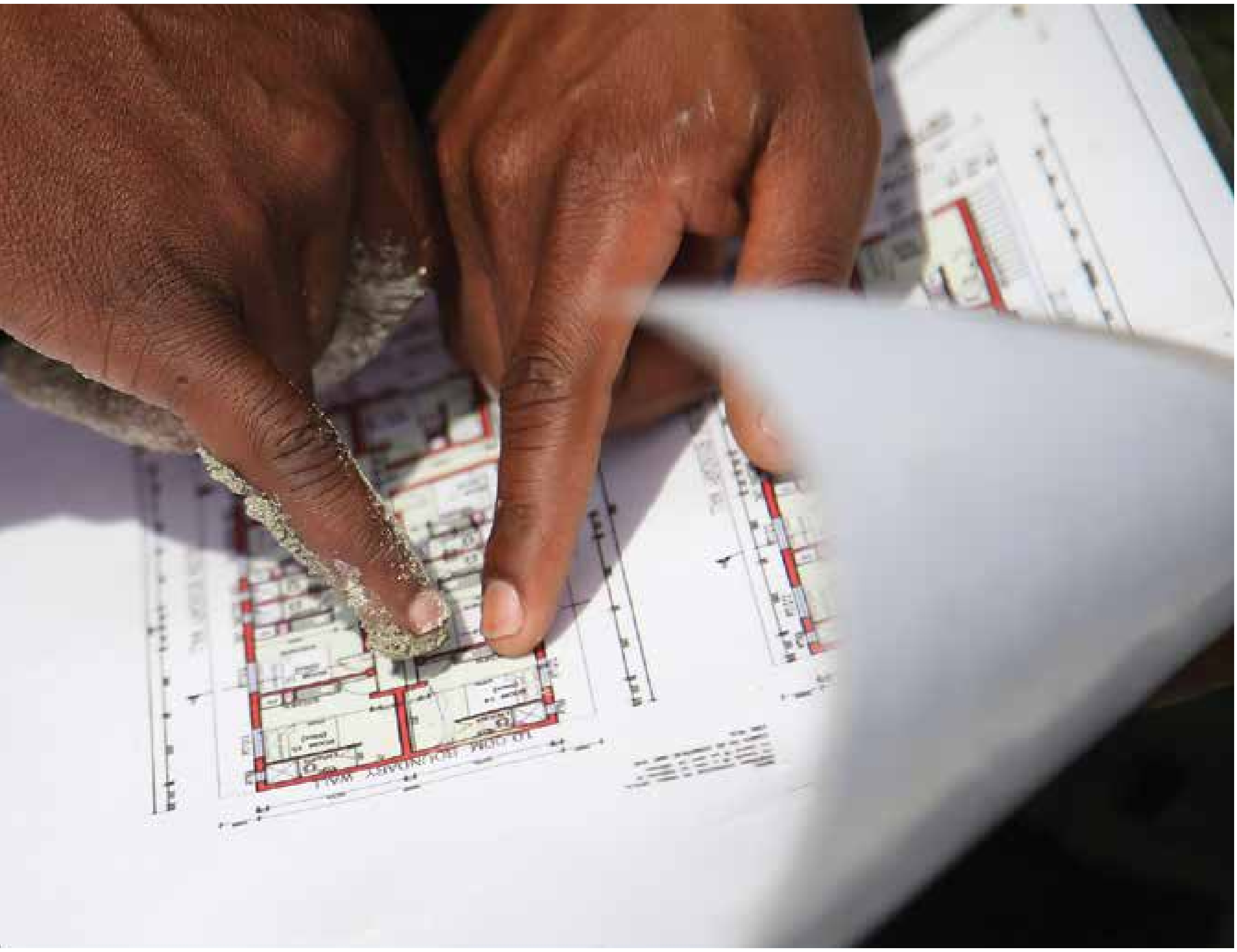

Enabling Affordable Rental Housing: Interplay of finance and planning policy

Development Action Group

Contents

BACKYARD MATTERS
ENABLING PEOPLE, PLACE & POLICY

This document is produced as part of the project Backyard Matters: Enabling People, Place and Policy. Backyard Matters is a partnership project initiative between Development Action Group (DAG), Isandla Institute and Violence Prevention through Urban Upgrading (VPUU). The project is aimed at strengthening the backyard rental market and contributing towards well-managed, quality rental stock that provides affordable, dignified and safe housing solutions. Backyard Matters is funded by Comic Relief.

What is Backyarding?

Rental housing development by another name

Originating in response to apartheid-era laws intended to restrict the number of black people residing in South Africa's cities, so-called 'backyarding' is a well-known South African practice[1].

Once the domain of individual households needing more space, informal shacks used to constitute its main typology, imbuing the practice with connotations of the informal and illegal. Despite the fact that the practice evolved to encompass many forms – some **40%** of backyard additions are believed to be formal brick and mortar structures[2] – perceptions of backyarding, especially outside of townships, remain largely negative.

Nonetheless the practice flourishes. Escalating in parallel with the country's urbanisation, backyarding has become a common way for **homeowner developers** to secure rental income. More recently, so-called **micro-developers** have emerged to meet the ever-increasing demand for affordable housing in urban zones, often by purchasing RDP homes or similar plots and demolishing the original structure to build blocks of 10-15 units for rental. Thriving entirely independently – and in some municipalities, despite the efforts – of both the state or the formal property development sector, these developers are supplying **affordable renting housing in townships** at a rate exceeding anything the public sector can achieve[3].

Recently recognised by the CoCT as a vital form of property development, it is high time to embrace backyarding as a form of 'renovation' or 'redevelopment', no different in principle to what occurs in nearby suburbs. Whatever you want to call it, this practice **holds the potential to shift the dynamics behind affordable housing provision across South Africa, simultaneously altering the possibilities for economic development in – and ultimately the nature of – the township itself**.

[1] See Scheba & Turok 2020 for a thorough discussion of the historical roots and evolution of the practice. [2] Urban Land Mark 2010; CoCT 2020. [3] CoCT 2020.

The **Evolution** of 'Backyarding'

Manoeuvering with an athletic grace around bags of cement, Tando Mdekazi* carefully climbs the stairs to the second storey of his 15-unit building-in-progress on a quiet lane in Mfuleni, Khayelitsha. **"I saw the demand for how much improvement needs to be done in our townships. I always thought 'we can do better than that',"** says the 30-year-old chartered accountant, gesturing to the sea of shacks below, tin roofs winking in the summer sun.

2.4m

national backlog in supplying adequate **[affordable]** housing[5]

As South African cities follow the continent's trend of rapid urbanisation[4], supplying adequate and affordable housing in particular, has become an increasingly complex challenge. **The housing shortage is particularly acute in Cape Town, South Africa's second largest city, a much-celebrated international destination known for its rising land values.**

Focusing on developing affordable rental units in the townships surrounding Cape Town, **Mdekazi** is part of a growing cohort of property developers operating in what is referred to as the 'backyard' or affordable renting sector (*see pg. 2*). Originally a response to apartheid-era laws intended to restrict the number of black people residing in South Africa's cities, backyarding is a practice well-known to anyone with the faintest knowledge of the country's urban landscapes. Once the domain of

* Names have been changed. [4] Over 66% of the country's population lives in urban areas https://data.worldbank.org/indicator/SP.URB.TOTL.IN.ZS?locations=ZA.
[5] http://housingfinanceafrica.org/countries/south-africa/ and https://www.news24.com/fin24/Opinion/a-solution-to-sas-housing-crisis-is-right-under-our-noses-20181224-2.

individual households needing to accommodate additional members, backyarding has evolved – particularly with the post-apartheid distribution of RDP (later BNG) houses[6] – to equally become a means of securing rental income.

Having flourished entirely independently – and in some municipalities, despite the efforts – of both the state or the formal property development sector, backyarding arguably represents the most ubiquitous and hands-on response to South Africa's lack of affordable housing, accommodating well over **1.8 million households in 2016**[7]**. Despite this contribution, backyarding remains largely synonymous with informality, and the less-than status accompanying that association.**

That said, a recent study in **Khayelitsha**; Cape Town's largest township, showed that nearly **40%** of backyard structures in the measure area met formal building regulation requirements[8]. Indeed, it is the robust demand for something better that has attracted so-called micro developers like Mdekazi to get in the game.

In contrast to the classic '**homeowner developers**' – characterised by **pensioners building a handful of units in their own backyards as a once-off exercise** – micro developers like Mdekazi are purchasing plots with an intention to **demolish what is there and build something new**. Though technically no longer a 'backyard' operation, whatever you want to call it, **this kind of property development has the potential to shift the dynamics behind affordable housing provision across South Africa**, and alter the possibilities for economic development in – and thus the nature of – the township itself.

[6] Since 1994, the government's main housing programme – the Reconstruction and Development Programme/Breaking New Ground (RDP/BNG) – has provided approximately 3.5 million free houses to low-income households (under R3,500/month) (Scheba & Turok 2020). [7] Brueckner 2018. That number has doubtless increased, given the fact that households living in informal backyard dwellings increased by 256% between 1996 – 2016 (CoCT 2020).
[8] CoCT 2020. [9] https://www.dailymaverick.co.za/article/2020-10-29-cape-town-city-council-approves-game-changer-report-that-could-help-solve-housing-backlog/

In September 2020, that potential was recognised by the City of Cape Town (CoCT)'s Mayoral Committee Members for Spatial Planning and Environment, which formally acknowledged the vital role played by this sector in addressing the city's affordable housing crisis[9] (*see below*).

With an eye on encouraging and regulating the backyard development already occurring, the CoCT approved recommendations to support this sector by easing regulatory burdens, facilitating and fast-tracking building plan approvals, and increasing bulk service infrastructure capacity in targeted areas, among other things.

'It's the first municipality in the country that has taken on coordination of these developments, so I commend that. But that process needs to be fast-tracked, because the train is moving, with or without the city,' says Mdekazi.

The City of Cape Town's Support for Affordable Rental Unit Development

In September 2020, the City of Cape Town (CoCT)'s Mayoral Committee Members for Spatial Planning and Environment formally approved the recommendations in the report: *Facilitating Small Scale Rental Units in Khayelitsha: Smart Citizen Action Adding Public Value in the Provision of Affordable Rental Units.* Evaluating the role of the backyard sector in providing affordable housing in Khayelitsha, Cape Town, and how the City could facilitate this activity, the recommendations are as follows:

- **Amending the zoning scheme** to encourage affordable rental development by creating overlay zones, or by adding small-scale rental units as an additional use within areas zoned as **Single Residential 2: Incremental Housing**.
- **Creating a menu of proto-typical building plans** for small-scale rental units from which the land owner can choose and submit to the City for approval in terms of the National Building Regulations.
- **Prioritising the assessment of building plans** in these areas, and waving fees subject to the property's rates and payments to the city being up to date.
- **Increasing service infrastructure capacity** in these areas.
- **Establishing a list** of accredited small local building contractors.
- **Hosting workshops in targeted areas** to create awareness and inform property owners of the benefits of small-scale rental units.

[9] https://www.dailymaverick.co.za/article/2020-10-29-cape-town-city-council-approves-game-changer-report-that-could-help-solve-housing-backlog/

A Question of **Finance**

Siya Lubengu's* newest plot for development sits in a prime position on Delft's Main Road. Lubengu plans to transform the 130 square-metre site currently occupied by a dilapidated shack behind a chain-link fence choked with weeds and rubbish into six brick and mortar rental units. In the five years that he's been in the micro-developer game, Lubengu has successfully developed two similar properties that he says have consistently enjoyed 100% occupancy and no troubles with rent collection. Nonetheless, he has struggled to secure attractive finance for this third project, mainly due to uncertainty around rezoning requirements. "**Finance remains the biggest challenge**," states the seasoned micro developer.

While players and experts in this space all agree that access to affordable finance is the biggest barrier for most actual and potential micro developers, they also express hope that the CoCT's pledge of support may be a game-changer.

* Names have been changed.

MENU OF FINANCE PROBLEMS

	The Model	Finance Approval based on:	Other Factors for Approval	Size of Loans	Cost of Finance	Payment Period	Security Held	Areas Worked	Main Funders	Training Offered	Marketing	Future Plans/ Builds
Bitprop	Property development partner funds and implements entire building process. Collects rent directly from tenants. Main clients: homeowners.	Income from rental units to be developed.	Owner under 45yrs, title deed secured, some income, aptitude and capacity for property management.	Average unit development cost is R550,000 (4 units).	To client: nothing upfront	10 yrs	Signed 'head tenant' contract, rental payments collected directly, with a 20% 'bad debt' allowance held for contingency.	Ilitha Park, Khayelitsha	Private investors	Assist with title deed procurement, approval education & homeowner training (when applying and during construction), tenant management training.	None so far: word of mouth.	Currently raising 5m to build 264 units across 40-60 properties.
uMaStandi	Developing high quality units with micro developers who will go on to invest in and build additional properties. Open to homeowner developers, but very few on the books in Cape Town.	Income from rental units to be developed.	Title deed, 20% equity, good credit, also 'character based' loan qualities, aptitude and passion to develop.	Minimum R500,000 (average loan 850k).	Prime + 5%	15 yrs	Title deed and equity.	Khayelitsha, Mandalay, Montclair, Delft/Delft South. Looking at: Blue Downs, Gugulethu, Langa, Eerste River. Also work in: Soweto and Johannesburg.	Jobs Fund, NHFC	Assist with debt/equity, title deed procurement, direct 24hr mentorship, three levels of training around business management.	Events, brochures, social media, etc.	Ten-scaling nationally where TUHF is already operational.
iBuild	Finance for affordable housing, which is defined by NHFC funding terms. Clients are a 60/40 split (homeowners/ micro-developers).	Minimum household income of R5500/month, also meets affordability requirements and credit conditions.	Title deed, mortgage on the title.	Minimum R60,000 (average loan 200-250k).	Prime + 8.5%	7,5 or 3 yrs	Title deed	8 branches in the Western Cape, 2 in the Eastern Cape and 4 in Johannesburg.	Habitat for Humanity, FSD Africa, NHFC, Praesidium Capital and Sofala Capital.	No formal training component, one client assigned to DAG's CDA.	Activations, radio, free press, also branches are located next to Cashbuild.	Currently expanding nationally, using a digital strategy (vs. building physical branches in new regions).

"*If [the sector] is being recognised officially, it opens up potential funding channels*," says Rob McGaffin of the City's announcement. A town planner and land economist at the Urban Real Estate Research Unit (URERU), McGaffin describes the City's move as 'a fundamental change in thinking' that could, in the long run, shift the narrative around finance for this space.

The first recommendation in the City's report is '**the amendment of the zoning scheme to encourage affordable rental development**'[10]. This bodes well for developers like Lubengu, whose project stalled under rigid interpretations of rezoning requirements that were going to add thousands of rands in fees and months of costly delays to his project.

The City's newly stated intention to create a more flexible regulatory framework around an existing economy activity is akin to decriminalising it, which is absolutely essential to its ability to attract finance.

As McGaffin notes, "*[Banks] can not finance illegal structures. So by the municipality sorting out that side of the equation, you move a massive hurdle out of the way*." And this is key; because until now, backyard developers in Cape Town have faced a very limited menu of finance options (*see pg. 7*).

Finance Options

The first – and by far most common – finance option is the one Lubengu used to fund his previous two developments. That is, an ad hoc combination of savings, personal loans, and credit cards.

With interest rates on most personal loans and credit cards coming in between **20-27%**, it is; however, an extremely expensive and thus often slow way to build, requiring the developer to work incrementally based on what he or she can afford.

That homeowner and micro developers alike continue to take on such an expensive form of finance speaks to how profitable the market can be, with an average return on investment reported at about **25%**[11]. Perhaps even more significant; however, is what this willingness suggests about the potential of appropriately designed and priced finance packages in terms of achieving the holy grail of scaling up.

This is where **TUHF (Trust for Urban Housing Finance)** comes in. The mortgage-finance trailblazer that opened up Johannesburg's inner-city affordable property development space in the early 2000s, TUHF launched **uMaStandi**, its pilot township development finance programme, in 2017. Seeing the massive demand, uMaStandi set out to regularise the township rental market by financing compliant, safe, and legal structures that would bring in the necessary profits for their developers[12]. Offering **minimum loans of R500,000** with **interest rates of prime + 5%** to be paid back over **15 years**, uMaStandi approves projects based on their **potential rental-income** rather than on the developer's own income, opening the opportunity to many more people. However, successful applicants must have **good credit**, **20% equity**[13], and a passion for development.

[10]CoCT 2020 [11] Rob McGaffin, personal communication, November 2020. [12] DAG 2018. [13] For example, on a project of R1million, the client must contribute R200,000 upfront.

Although TUHF initially envisioned an equal mix of homeowner- and micro-developer clients, 99% of its loans in the Cape Town area have ended up going to the latter, simply due to demand. But for those who do qualify, the service is bespoke, with training and mentorship of clients considered integral to its model.

"*It's character-based lending, we are heavily invested in training and passing on skills. We also have a developmental mandate, it's part of our founding structure that we fundamentally believe in transformation of ownership and skills*," explains Katherine Cox, research, development, and innovation manager at TUHF, of the close personal relationships that are at the core of TUHF's model. With R25.6m of loans on its books, 38 entrepreneurs supported, and another R54m in approvals, uMaStandi officially shed its pilot status in 2019, and is poised to ten-scale in a national expansion over the next few years.

Around the same time that uMaStandi launched, two other notable players arrived on the Cape Town scene. Like uMaStandi, Bitprop, sees itself as a development partner that strives to enable its clients to make the most of their land assets, while also meeting the need for producing better quality rental products in townships. "*70% of the world's urban poor have land, but no title. We were interested in seeing how can we create a pensionable asset for a homeowner*," says

Claire du Trevou, Bitprop's lead architect and co-founder, citing Peruvian economist Hernando de Soto's figure.

Opening its doors in 2018, Bitprop offered a model catering to **homeowner developers** (versus micro developers), in which it plays the role of property development partner rather than straight financier. Entering into what it calls a 'head tenant agreement' with the homeowner, Bitprop both funds and implements all aspects of the construction of the rental units in question, from supplying a handful of design options, to getting plans approved and managing the entire building process. In exchange, Bitprop holds the primary lease rights on the units, receiving direct payment from tenants, and paying a portion of the rental profits back to the homeowner until the capital investment is fully recouped – usually over **ten years**.

While taking responsibility for all aspects of the actual development as well as the rental management, Bitprop offers its clients homeowner and tenant management training so that when the partnership term is up, they have the skills to successfully carry on as property managers. Like uMaStandi, Bitprop's affordability is based on **rental-stream potential** as opposed to the homeowner's income or credit standing.

Unlike uMaStandi, it does not take a mortgage over the property or require equity, making it particularly attractive for people who operate in the informal economy and/or lack capital assets.

Between uMaStandi and Bitprop is **IBUILD**. Operational since late 2016, IBUILD requires applicants to have a **minimum household income of R5,500/ month** – proven either through bank statements showing three months of fulltime employment, or six months of self-employment and/or 'piece' work – and good credit. Clients are given mortgage-backed loans with a **repayment rate of prime + 8.5%**, making IBUILD's finance more costly than uMaStandi's, but far more competitive than that of personal loans or credit cards. With **minimum loan amounts of R60,000**, payback periods of **three, five, or seven years**, and **more flexible employment requirements**, its model is also more attractive to homeowners, into which category **60%** of its clients fall. However, this profile appears to be changing.

"*Initially our typical client was a granddaughter or son applying on behalf of their grandparent to add two rooms at the back*," explains iBuild CEO, Sibusiso Zitha. "*But as the business grew and demand for our products increased, we started attracting developers like Mdekazi*," he says of the Mfuleni development that iBuild financed after Mdekazi failed to qualify for a loan from the traditional banks he approached.

Unlike uMaStandi and Bitprop, IBUILD does not have a training or mentoring component built into its model. However, this too may change. "*Training is absolutely paramount*," Zitha asserts. "*We recently received grant funding from the FSDA for purposes of training and mentoring. That funding will be used towards training clients in understanding financial products, how the property market works, title issues, what it means to mortgage your house, how to manage your tenants – there's a serious need for education*," affirms IBUILD's CEO.

While this need is partially acknowledged in the CoCT's recommendations – in the form of hosting workshops, creating a menu of proto-typical building plans, and establishing a list of accredited local building contractors – how the broad strokes of principle will translate into on-the-ground implementation remains unclear.

Paving the Way

From land value fluctuations, to the building process with its multitude of potential delays and unanticipated costs, to the fact of the investment being captured in a fixed asset, the 'delivery risks' associated with the development sector at large underscore the need for newcomers to the sector to be trained and supported if they are to produce a meaningful quantum of quality accommodation.

"*Development finance is incredibly risky, which is why a lot of banks don't like it, full stop – it's not just these [backyard sector] products,*" notes URERU's McGaffin, referring to the necessary involvement of numerous players over uncertain timelines and the non-transferable end-product, be it in Khayelitsha or Camps Bay.

All of these issues are further amplified in the township context, where the strict application of the regulations and bureaucratic processes undermines developers' ability to supply stock at an affordable rate[14], there are fewer skilled contractors with experience building at scale, and higher levels of criminality are a fact of life. On top of all this, the title deed backlog is a nightmare.

[14] With the notable exception of the example set by the Khayelitsha District Office, discussed below. Also, developers in the 'suburbs' generally are better equipped to deal with the regulations and processes, thanks to having access to more experienced professional teams.

Taken for granted in the higher ends of South Africa's formal residential property market, title deeds are the foundation on which property transactions – including development – rest.

850,000 to 1m

owners in the lower-end of the formal market across the nation, currently **without title deeds** to their properties[15]

The reasons for this problem are beyond the scope of this paper, but even in the most straightforward of cases, rectification can take 'a couple of months', according to Illana Melzer of the Transaction Support Centre (TSC), who facilitates formal residential property market transactions within the affordable market[16]. "*I don't know how to say it in words that will make people sit up and take notice*," says Melzer of the grand proportions of this problem. Suffice to say that acquiring a missing title deed demands the savvy, persistence, and resources of a private investigator, and entails visits to numerous offices, often crossing all three spheres of government, to locate the correct official, documents, signatures, etc.

In short, the ability of thousands of homeowners to legally leverage their properties as assets is being thwarted by this profound bureaucratic failure. While the TSC is investigating innovative workarounds such as '**blockchain titles**'[17] – where a '**shadow property value chain**' could serve as a complementary system alongside formal title deeds – the bankability of such a solution remains unclear. However it is handled, the issue is **national in scope**, and should be a **priority public sector goal**. "*If you want people to formalize, make it a no brainer*," says Melzer of the need to streamline a solution.

While claiming one's title deed is the first step in the regulatory labyrinth, further administrative twists and turns await would-be developers. From building plan submissions to rezoning, the processes are slow, laborious, and often unclear, increasing a developer's costs, and thus reducing the amount of quality backyard development that can be produced. Many who attempt to navigate these processes without support ultimately give up – potentially resulting in the side-stepping of regulations or cutting of corners.

That said, the **provision of support and assistance can make all the difference** to both the quantity and quality of backyard development. This reality was demonstrated by the Khayelitsha District Office, where the team under the leadership of district manager Charles Rudman took a '**whole value approach**' to local property development.

"*We were trying to bring the private sector to Khayelitsha [to develop], but they were not interested. It was individual property owners who identified this opportunity and were trying to grow it up, so my view was 'how could we reinforce this?*'," Rudman recalls.

The answer was encouraging building inspectors to see themselves as 'ambassadors' delivering 'a relevant service' that existed to 'facilitate, uplift, and create public value', as Rudman describes it. In other words, empowering building inspectors to serve as developmental officers who play a supportive rather than narrow regulatory role. In practice this meant that the Khayelitsha District Office interpreted planning rules

[15] Centre for Affordable Housing Finance in Africa and 71point4, 2020; also see: https://www.groundup.org.za/article/hundreds-thousands-homeowners-do-not-have-title-deeds/. [16] A joint pilot initiative of the Centre for Affordable Housing Finance in Africa (CAHF) and 71point4 (a research consultancy where Melzer is lead consultant and co-founder), the TSC is based in Khayelitsha. Since 2018 it has been offering the range of critical services households need to transact formally in the residential resale market. https://www.71point4.com/Projects/the-transaction-support-centre/.[17] The existing property value chain–the interconnected system that enables the city to generate revenue out of a property–hinges on title deeds registered at the deeds office. A permissions-private blockchain deed would be the basis of a complementary 'shadow' system, where validated participants authenticate specific transactions (e.g., a City official authenticating that property X exists and was sold to beneficiary Y on a certain date for a specific amount). Such a complementary system would allow properties that are not registered for whatever reason to maintain a secure, up to date record of transactions until such time that the impediment to "official" transfer has been removed. (Illana Melzer, personal communication, November 2020). Also see: What Is Blockchain Deed Registration in Real Estate? (propy.com).

and regulations in the most enabling manner possible, while remaining unyielding on the four key principles of public health, public safety, fire safety, and structural stability. Developing a reputation for service delivery, the district unsurprisingly saw more people submitting plans and building according to regulations[18].

"*It's about being open to discussion and looking for alternatives, always asking how do we make the best experience for our clients? That's the attitude we need to instill in our staff*," Rudman says. In fact it was the Khayelitsha District Office's example that led the City to commission the research into the sector – including the role the City could play to better support it – that ultimately resulted in the City adopting the new measures to support the sector.

"*It was a big story for the city: that private individual property owners were actually making a major contribution to the housing backlog*," says Rudman, who has been assisting in developing the City's programme of support for the sector. One of the first practical steps taken under the programme has been to develop an MOU with uMaStandi.

"*It says we will continue to deliver quality and compliant affordable housing in these focus areas, and in return [the City] will be open to communication and making allowances in particular instances where norms and standards may not be so relevant, as well as to fast-track approval of building plans, rezoning, and any 'right to build' issue*," says TUHF's Cox of the discussions so far. Although still being finalised, such an MOU could serve as a first draft to help define a regulatory framework that better aligns with the City's progressive intentions.

The institutionalisation of such regulatory reforms – making the rules and regulations relevant to the sector, as opposed to continually trying to force the sector to conform to what in some cases are inappropriate or arbitrary conditions – would be a major turning point.

[18] CoCT 2020; Also, the highest number of building plans approved within the City were in the Khayelitsha District Office; significantly, these were not high value plans. Also, the Khayelitsha District achieved a turnaround time for building plan review in excess of 90% within 30 days as required (Charles Rudman, personal communication, November 2020).

"*The moment the public sector support is institutionalised and there are regulations that address some of the gaps we've identified; like speedy planning approval – then other things will fall into place, such as finance institutions being comfortable to invest in the sector, and more responsible development from the side of developers*," says Zama Mgwatyu, a programme manager at the Development Action Group (DAG).

An NGO with a long history working for urban land rights in the Western Cape, DAG has been keenly observing and actively participating in and supporting this sector[19].

But while DAG sees a revised regulatory framework as a huge step forward, and applauds Rudman's vision of building inspectors as boots-on-the-ground support officers, it also believes that government alone cannot deliver on its mandate of housing delivery and economic transformation.

As a result, in 2017 DAG launched its **Contractor and Developer Academy (CDA)**. Supporting emerging property entrepreneurs in the affordable market, the CDA assists with all aspects of micro development, from **information provision** (highlighting compliance with regulations) to running a **6-week contractor training course linked to live projects**. It then offers ongoing mentorship and technical support to developers, including end-user assistance with things like property and tenant management, and also connects developers to both public and private sector networks. Having visited 20 sites last year, the CDA is currently assisting seven projects.

Unlike Bitprop, whose focus on 'once-off' homeowner developers means there is less need for the transfer of property development skills, the CDA does not do the work for its clients, but rather advises alongside. Like uMaStandi, which pairs each client with a mentor, and provides close contact with the regional portfolio manager as well as multiple trainings, the CDA sees the relationship with each developer as a long-term commitment.

Although IBUILD has yet to incorporate a training or education component into its model, it introduced Mdekazi's Mfuleni project to the CDA, and CEO Zitha acknowledges the value stemming from this relationship. "*If [the CDA] could scale to be much bigger that would make a world of difference, because there's a serious education deficit in the spaces we're operating in*," Zitha says.

While Mgwatyu also sees the relationship with IBUILD as a pilot for how the CDA could operate in concert with finance providers, the Centre consists of only three staff members, and currently does not charge for its services. Although espousing an '**each one teach one**' methodology – where each developer or contractor who goes through CDA training commits to mentoring someone else – for the CDA or any similar body to sustainably make a difference at scale, its services must be incorporated into project finance calculations, and its operational model re-evaluated and adequately resourced.

McGaffin agrees on the value of a support component for emerging developers in this sector, and sees a role there both for NGOs like DAG/CDA, as well as municipal housing departments. But he also feels that over time, the market should start to take care of this need. "*If [the sector] is as big and viable as we all think, then the market will train these people up – it'll come*," he says, citing an example of 15 guys moving from site to site, and receiving a "*huge amount of training in that process alone*."

[19] Since 2017, DAG has been involved in site analysis, drafting and costing of building plans, facilitating access to finance, linking micro developers to credible construction companies, construction project management, capacity building, drawing up of lease agreements, and tenant and property management.

The **Big** Guys

As little as five years ago, there was not a single formal finance package tailored to meet the needs of the backyard property development market in townships, whether by homeowner or micro developers.

Today, in addition to those discussed in this paper, at least half a dozen other players exist[20], many working in tightly defined geographic areas, each offering its own model and catering to particular segments of the market.

With more players entering the space, the absence of traditional finance becomes increasingly stark, begging the question of the role that banks can or should be playing.

Bitprop's du Trevou thinks that perhaps this is the wrong approach. "*I feel like their responsibility is to step aside and let the emerging solutions come through*," she says, suggesting that financers view micro developers as start-ups as opposed to traditional property developers, with funding, training, and administrative support requirements handled accordingly. "*I think innovative crowdfunding products and open-sourced solutions will emerge in decentralised ways. So while the traditional financial sector is trying to understand how to respond within their current structures, other more nimble organisations are taking action*," she adds.

[20] Other players include EasyEquities/EasyProperties, Indlu, and Xtenda (the latter two operating mostly in areas in/around Johannesburg).

Indeed, operating within the extremely tight regulatory space of Basel regulatory frameworks – which also make long-term funding more expensive – banks lack the flexibility and responsiveness that in many ways are the backyard sector's trademark strength. Despite the sector enjoying returns of about **25%**, its demonstrated need for training and support represents an additional cost and disincentive. "***The support side is not [the banks'] core business. They may be willing to partner, but they're not going to do that as internal function***," says McGaffin, who points to the expense of Basel-regulated long-term funding and how that further impacts a bank's inclination to cover training and support costs.

Ragi Bashonga, an urban land policy researcher at the Isandla Institute, an urban governance NGO, agrees that the backyard sector is not an obvious match for traditional finance. Like du Trevou, she sees the start-up lens as useful to conceptualise the investments that finance providers should consider as part of covering "***the more technical aspects of running a business to make sure the venture succeeds and they can scale up***." Bashonga also suggests a multi-stakeholder approach to exploring the finance question.

In fact, that is exactly where Bitprop is headed. Having completed **six projects** yielding **34 rental units**, the company is in discussion with several banks about 'repackaging' clients to apply for traditional home loans. Title deeds sorted, units built, tenants on the books reliably paying rent, these homeowner landlords can utilise a track record of rental income to qualify for mortgage-based loans, thus freeing Bitprop's capital to invest in new homeowner developers.

The beauty of this model is that someone who started out as a homeowner with no equity other than property – and possibly not even with a regular income – could end up with a reasonably priced home loan. On the flip side; however, Bitprop has had to adjust its client profile to align with bank requirements – meaning older (over 45) and riskier clients (people with any credit issues) no longer qualify. That said, the company hopes that over time data accumulated through successful projects will eventually allow it to return to servicing these marginalised groups.

In addition to possible partnerships with companies like Bitprop, there is another meta-role that some banks are already playing. That is, funding **DFIs (development finance institutions)** such as the **National Housing Finance Corporation (NHFC)**, supporting government subsidy programmes like the **Finance Linked Individual Subsidy Programme (FLISP)**, and investing in bulk infrastructure.

An example of the latter can be seen in the recent partnership between Standard Bank, Calgro M3, and the City of Johannesburg for the **R3 billion South Hills development, which will produce about 4,000 affordable housing units less than ten kilometres from downtown Joburg**[21].

With South Hills anticipated to use only about **40%** of the power from the substation that the bank is financing as part of the project, some people argue that such investments open up a space for other affordable housing financers like TUHF and IBUILD to play. However, DAG's Mgwatyu points out that supplying infrastructure for such greenfields projects is fundamentally different from investing in infrastructure provision for the brownfields development needed to improve the lives of millions in existing townships, and which ultimately is the responsibility of the public sector.

All of that said, the more players involved the better, and opening the field up will necessarily be a multi-stakeholder proposition. "***I see the TUHFs and IBUILDs laying the foundation, testing the market, helping to bring better understanding of that market, which costs a lot to do.***

[21] https://www.standardbank.com/static_file/StandardBankGroup/Why%20we%20matter/Our%20impact/PDF/Report_to_Society_2019.pdf

They're almost paying the 'school fees' for the bigger players," observes McGaffin wryly of the likelihood that traditional finance will only truly jump in once the pioneers have proven the models.

Which brings us back to the perceived riskiness of the township market. In sum, the biggest risk for a financer is losing their investment, and the reluctance of banks to finance mortgage-backed property loans in townships is based on fear around whether they can execute on that security. In other words, if a borrower defaults, can the bank lay claim to the property, and how much value would it then reasonably capture from that possibly half-finished development?

"*What is not tested in this market is what happens when someone doesn't pay back a development loan. Are there a lot of buyers sitting in Khayelitsha who will take it off your hands? There are a lot of question marks still out there*," McGaffin concedes.

Of course, there is also no evidence showing that a bank cannot foreclose on a township property. Most people with experience in this space suspect that fears to the contrary are as much a product of ignorance as anything else.

"*We've got well-established private property laws in South Africa. They are as stringent in Camps Bay as in Khayelitsha*," says IBUILD's Zitha, who, while not having had to exercise that security, questions the notion that 'social backlash' or 'lawlessness' would undermine the legal process. "*If you buy a property through a bank and can't repay, they will take your property, and you can't throw your toys. That's part and parcel of how a mortgage loan agreement works. So yes, it's not as common [in the townships] as in suburbia, but more and more, the understanding is growing*."

The things we know we don't know

While foreclosure risk is the unknown with the most dire consequences, it points to a larger information deficit when it comes to township economies in general, and the property market in particular. Filling that gap would go a long way towards opening the sector for more investment, but the backyard market's niche environments complicate this task. "*One of the things that stands out about the backyard sector and makes it difficult to come up with a product or intervention for the sector, is that they can differ greatly depending on which context you find yourself in*," explains Bashonga.

Indeed, the finance providers in this space loan in very specific neighborhoods (and not in others), and do so because they have done their homework and are intimately familiar with the areas they work in and the people they fund. But as Charles Rudman demonstrated in his 2020 report for the CoCT, collecting information on this market is entirely possible if the will to do so exists.

Given the extreme dearth of information, stakeholders say that even just the fundamentals of the township housing and tenant markets would be incredibly helpful (see pg. 18). In terms of collecting this data, McGaffin suggests that Human Settlements and municipal housing, planning, and valuation departments are well-placed to do the job, and in some cases already are. "*We need better information on how these properties transact – how many, for what price, and we need to value them properly. Because that's what the banks need to make informed decisions, but also, to help break some of these quite spurious shooting-from-the-hip perceptions about [townships]*," he says.

One solid piece of information that has emerged about this market concerns the **reliability of rent collection**. Although still only anecdotal, the evidence overwhelmingly points to an almost non-existent default rate in the formal backyard rental market, which is likely related to the incredibly high demand for these units.

With the COVID-related economic downturn of 2020, concerns about non-payment barely manifested in this space, standing in stark contrast to the middle-class rental market, where landlords were routinely asked for rent relief of up to 50%.

Homeowners at the lower end of the market are equally reliable. "*We know that affordable housing customers are more committed to paying for and keeping their homes than other sectors*," affirms Mfundo Mabaso, Head of Growth, FNB Home Finance.

IBUILD's experience also confirms this: "*For most of our clients, the biggest asset they own is this house. Either it's government-issued by way of RDP, or over time it's been kept in family. And when you lend money and say 'I'm holding your title until such time as you pay me back', there's an interesting psychological effect, which is: I can't lose it so I have to pay this. So that takes away the perceived risk*."

What we know we don't know

The fact that banks are still wary of this sector, with its reported returns of about 25%, is seen by some as a classic case of market failure. While the narrative around this market is one of 'high risk', there is actually very little data about township economies in general, and the housing and rental markets more specifically. Areas highlighted for research are:

- How do we understand the activity in the affordable rental development sector? That is: pace (how many units produced per annum), location, built with/without building plans, value, revenue?
- What is the split between homeowner and micro developers?
- How many rental units exist per square kilometre: where are they, and what is proximity to social amenities and infrastructure
- How many formal property transactions are taking place in townships, how often, and at what price points?
- Data on residential patterns and determinants of rent: what influences rental costs? How often do renters move (and how far)? Where do people go when leaving a backyard unit? Ratio of tenants that are relatives (versus purely renters)? How often does it take a renter to find an affordable unit?
- Percentage of households with title deeds, correlated by neighbourhood.
- Data on township residents' credit standing, broken down by demographics
- If the development happening is proven safe, what can be done to upscale and what are the implications?

Lessons from the Township

Although he is still figuring out the finance for his third development, Siya Lubengu has already submitted his building plans.

"Originally we wanted eight units, but we'll limit to six: more spacious, with a lounge. Quality-wise, we need to come up with something classier," Lubengu says, explaining that with more units becoming available, he needed to differentiate his offering to remain competitive.

Although the weed-choked site doesn't look like much right now, viewing its prime position on Main Raid – minibus taxis pass by every few minutes – through Lubengu's visionary and steadfast perspective is nothing short of thrilling. In fact, to research this sector is to experience an unusual sensation when it comes to exploring questions of affordable housing in South Africa; in a word: optimism.

An excitement animates the people who work in this sector. "*More and more we are conscious of our financing being more than just money, but a tool for changing social spaces. It's difficult to imagine that the townships could look cleaner and safer than the current slums that we perceive and experience them as. But it's players like us and the products that we are offering that will lead to the township becoming a liveable space that's dignified rather than what apartheid intended it to be. For me, the biggest drawcard in joining this industry is it could lead to a huge improvement in the general standard of living of people and the township in a way that the government cannot achieve alone*," says Zitha.

Thanks to the City's endorsement of the sector, bold private investors will likely start flocking to this space with its potential for innovation, transformation, and healthy returns. The key now is for that multi-stakeholder approach to take hold, for people to work together to assemble the pieces that already exist, and to use technology (like a Facebook page for affordable rentals that DAG set up) to collect the data that will help de-risk the sector.

"*If you can build an infrastructure that gets this ecosystem of different players working better together, more seamlessly, more stock will be delivered, which meets our aim: that is, contributing towards ending the housing backlog. There won't be one company to dominate the space with so much demand. There's actually such limited supply at the moment, so how do you position everyone in the system to deliver more and collectively grow the market?*" comments Brett Wilks. Previously CEO at Boschendal wine estate, the trained architect is now CEO at **Hello Nandi**, a new privately funded company with big, collaborative investment plans for this space.

The entry of individuals like Wilks into the sector points to the exciting possibility that this is not just a township story.

That is, the growth of the micro-developer property market has the potential to simultaneously move the dial on the housing, employment, and integration crises that in many ways have stymied the nation since 1994.

Gaps and **Recommendations**

- **Coordination between spheres of government concerning infrastructure provision**
  - National:
    - rather than giving subsidies, allow deferred development contribution payments and/or incorporation into rates payments.
    - Use of MIG (municipal infrastructure grant).
  - Provincial:
    - Conduct research around areas to target for the sector, and what infrastructure and social amenities need to be upgraded accordingly.
    - Western Cape Rental Housing Tribunal to take a stronger role in matters relating to the rental market, especially ensuring that their education campaigns and programmes should incorporate this thriving sector.
- Title Deeds: Streamlining a solution to the backlog of title deeds should be a national priority
  - Support for and collaboration between Transaction Support Centre and any other players working on the title deed issue.
- **Municipal regulatory frameworks must be clear and speak directly to this sector.**
  - Consistency in how district officers interpret rules and regulations.
  - How to instil the 'ambassadorial' spirit in building inspectors.
  - City to explore additional roles to play beyond 'regulating', including implementing bulk infrastructure in partnership with national government.

- **Finance gaps**
  - Equity funding for this sector is non-existent.
  - Government should play more of a role in making more affordable finance available: institutions receiving government funding should cater to or create different packages that speak to the different needs of homeowner and micro developers.
    - Align existing financial institutions and mechanisms.
    - NHFC and (future) Human Settlements Development Bank should play a more active role in engaging with financial institutions and making loans to micro-finance institutions (with the condition that they provide more affordable loans to these developers).
  - Homeowner developers must not get excluded.
    - Finance will always bend towards the larger players. It is critical that finance packages for homeowners – including people who are older, lack steady income, or may have some bad debt – exist.
    - Ensure that as typologies expand to more spacious units with better finishes, the lower affordable end users are not left high and dry.
  - Finance for planning and approval costs of a project (professional fees, rezoning, etc.).

- **Support and Training:** role of contractors and building construction value chain is essential, and strengthening the skills and capabilities of local construction companies could resuscitate an isolated, and often underutilised construction sector in Cape Town.
  - The Construction Industry Development Board (CIDB) is intended to develop and capacitate emerging contractors, and could play a more active role here.
  - Targeted training programmes, with:
    - Access to alternative building technologies.
    - Tools to enable contractors to tender for work.
    - Access to technical experts (architects, engineers, etc.).
    - Tools for quantity surveying.
  - Encourage hands-on, on-site support from building inspectors.
  - CDA type body in a formal partnership with micro-financers that lack a training or mentoring component.
  - Incorporate training or mentoring into project costing.

- **Safety and Design**
  - NHBRC should play a more active, facilitative, developmental role.
    - Work on adapting NHBRC building regulations to secure a greater number of formal structures.
  - Design innovation
    - Use of prototype building plans that employ alternative technologies to build greener structures.
  - Holistic strategies for sustainable and liveable neighborhoods: with increased densities brought by new rental stock, there is a need for specific targeted funding for public space upgrades and neighbourhood design, specifically:
    - Social amenities: schools, clinics and parks
    - Roads and transport services
    - Considerations around vehicle vs. pedestrian access
    - Support to home industries / mixed use development
    - Wifi zones

- **Communications & Technology**
  - Creation of micro-developers forum to lobby as a collective voice that can engage with the city and finance.
  - Creation and use of apps and social media to:
    - Link rental market landlords and tenants while simultaneously collecting data about the market.
    - List, connect and review accredited contractors with projects.

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+27 (0)21 448 7886 • dag@dag.org.za
101 Lower Main Road, Observatory Cape Town, 7925

www.dag.org.za