

**TESTING THE APPETITE OF POTENTIAL PLAYERS IN THE  
HOUSING MICROFINANCE FIELD TO DEVELOP NICHE  
LOANS FOR BACKYARD SHACK FORMALIZATION**

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by

**Eloise Rousseau**

Supervisor: Prof Joshua Abor

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## GLOSSARY OF TERMS

Backyard shacks	Informal or makeshift dwelling constructed in the backyard of a private property and used for rental by other poorly housed families or individuals. Typically made from inadequate building materials such as corrugated iron sheets, wood and cardboard.
Backyard dweller	Individual (s) living in a backyard shack.
RDP house	A fully government subsidized house delivered through the Reconstruction and Development Programme (RDP). The form of the house is based on the suburban model of a single house positioned in the centre of a property. This programme was replaced with the Breaking New Ground Policy; however for ease of reading, the RDP house will be used as a reference for any fully government subsidized housing.
RDP recipient	An individual who received a fully subsidized RDP or BNG house.
Tenant	The individual residing in the backyard shack that pays rent to the property owner of the property on which the backyard shack is constructed.
Potential Players	Organizations that are not currently directly involved in HMF, but that could become involved in future. This includes commercial lenders, unregulated lenders, MFI or NGO's.
Players	Organizations that are directly involved in HMF.
Niche Loan Product	A conceptual type of loan (of which the parameters are flexible for the purposes of this research) specifically targeting RDP recipients and which is to be used to upgrade backyard shacks.
Financial Lined Individual Subsidy programme (FLISP)	A government programme that extends housing access to those whose earnings exceeded the cut-off for subsidized RDP units but who cannot afford housing in the open market. FLISP links a limited subsidy amount (that reduces with increasing income) to housing purchased using mortgage finance.
Informal settlement	A settlement with no formal township establishment and which is generally not serviced with electricity, sewerage infrastructure, formal roads and water.
Informal dwelling / house	A dwelling that does not meet housing standards, also referred to as a "shack". This term is inclusive of backyard shacks
Small-scale rental unit	Affordable rental units, of which some are informal, built on privately owned land by the private owner.
Public Housing Projects	Housing that was developed and subsidized by the government; inclusive of RDP and BNG housing projects.

## ABSTRACT

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Backyard shacks prevalent in new government-sponsored housing developments is a distinctly South African phenomenon (Lemanski, 2009). Conventional housing finance and government housing delivery systems have consistently failed to meet the housing needs of lower income South Africans (Sisulu, 2005); however the informal market has responded to the housing need. The rate at which new households create informal housing now exceeds the rate of government housing - and infrastructure provision (Durand-Lasserve et al, 2002).

Backyard shacks in formalized areas create a number of problems relating to urban management and public health (<http://www.hsrc.ac.za/en/review/hsrc-review-may-2013/census-2011-reveals-boom-in-backyard-shacks>, accessed on 10-12-2013); however backyard shacks have enormous potential as a means of achieving high-level government policy objectives such as densifying existing serviced neighbourhoods. South Africa's policy environment has not been successful in unlocking the potential that backyard shack formalization holds. Government interventions such as the provision of grants and subsidies have resulted in sub-optimal allocation of resources and unintended negative consequences.

Housing Microfinance (HMF) is increasingly viewed as an important tool that can facilitate access to affordable, appropriate shelter for lower-income households (Daphnis and Ferguson, 2004); however the industry's potential remains untapped (Kihato, 2013). Whilst there are ranges of potential players in the HMF field that may be better positioned to intervene in the formalization of backyard shacks by means of providing financing products, they are not incentivized to achieve the high-level government policy objectives that have driven the unsuccessful government intervention thus far.

This study tests the appetite of potential players in the HMF sector to develop a niche loan targeted at beneficiaries of government-sponsored houses, which can be used to finance the formalization of backyard shacks. Concerns around - and prerequisites for involvement in such an initiative were identified by means of conducting in-depth interviews with potential players in the HMF sector.

The major concerns around involvement in the development of a niche loan related to using a RDP house as collateral for a loan and to social justice concerns in terms of assisting RDP recipients and not backyard tenants. Prerequisites for involvement related to partnering with other potential players and the community and to educate potential clients on personal finance and encourage investment in their own properties.

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# CHAPTER 1

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## 1. INTRODUCTION

### 1.1 SETTING THE CONTEXT

#### 1.1.1 Urbanisation and Informality

In 1987, urban economist Bertrand Renaud stated, “Cities are built the way they are financed”. Today, this rings true more than ever. For the first time in history, the global urban population outnumbers the rural population. This wave of urbanism has had major impacts on the form of cities that are unable to deal with the influx of migrants from rural areas. A significant feature of developing cities is burgeoning informal settlements. UN-HABITAT estimates that one billion people live in informal settlements and that this number is predicted to double over the next 30 years (Lemanski, 2009). In South Africa, nearly one fifth of urban households reside in an informal dwelling (Lemanski, 2009). Such informal settlements reflect the enormous unmet demand for housing finance services from a rapidly expanding poor urban population and can be considered as a manifestation of, inter alia, the market’s inability to deliver affordable housing (Maholtra, 2002).

The massive shortages of affordable shelter in most developing nations are one of the most pervasive development challenges to overcome (Gardner, 2008). Informal construction on land that is not serviced results in severe urban management issues and in abysmal and unsafe living conditions. Informal settlement formation creates immense unfunded public and private liabilities. Informal settlement upgrades are extremely costly, as the provision of retrospective basic infrastructure typically cost double or triple of that in new formal development (Ferguson, 2003). Curbing the formation of new informal settlements is extremely important in terms of managing the spending of limited public funds. This makes the production of low-cost housing as important as the upgrading of existing informal settlements (Ferguson, 2003). In Sub-Saharan Africa, rental housing plays an important role in the provision of adequate shelter, as many individuals cannot afford to purchase the least expensive commercially built unit available on the formal market (Ferguson, 2003). More than 85% of housing in African cities such as Lagos are in the form of rentals (Beck et al, 2013).

#### 1.1.2 South Africa’s Housing Legacy

Insufficient and inadequate housing for the urban poor has a long history in South Africa (Lemanski, 2009). Apartheid-era policies relating to urban

containment resulted in overcrowded and under-serviced townships and informal settlements on the urban periphery (Lemanski, 2009). South Africa's political history of racial segregation remains reflected in the cities of today. Urban areas' development challenges, although magnified by the process of urban growth, remain rooted in the history of deep structural inequalities in South African society (ICDG, 2013).

Post-1994, the ruling party in South Africa had a campaign promising "houses for all". This was delivered through the Reconstruction and Development Programme (RDP), which provided fully subsidized housing based on the suburban model of a single house positioned in the centre of the property. Despite the significant number of subsidized housing units produced in South Africa, the waiting list remains long (Gardner, 2008). As housing backlogs continue to grow, there is mounting consensus that the government cannot deliver housing on the scale required (Urban Landmark, 2010).

Post-Apartheid provision of state-funded housing for the poor has created a new class of cash-poor homeowners (Lemanski, 2009). Those individuals lucky enough to receive a free RDP house will experience an improvement in their living conditions, but in most cases, this is not accompanied by an improvement in their financial status (Govender et al, 2011). As the new owners have excess space on their serviced property, they soon exploit this space by erecting informal or makeshift dwellings in their backyard (Govender et al, 2011). These backyard shacks are typically constructed from inadequate building materials such as corrugated iron sheets, wood and cardboard and are used for rental by other poorly housed families.

35% of the 2.4 million South African households who rent their primary accommodation live in small-scale rental units built for rental by a private landlord on privately –owned land (Urban Landmark, 2012). The number of houses, flats and rooms being constructed in South Africa on existing properties grew at a rate of 83% between 2002 and 2006 (Urban Landmark, 2012). Although a proportion of these small-scale rental units do not meet recognized South African housing standards, this sub-sector is one of the most successful, efficient and pervasive accommodation delivery systems in South Africa (Urban Landmark, 2012).

The Financial and Fiscal Commission estimates that 945000 households in South Africa live in backyard shacks. The majority of these households earn between R0 and R3499 per month (FFC, 2013). The proliferation of backyard shacks is indicative of a new generation willing to pay rent for a smaller, but well-located unit or room that has access to water and electricity.

### **1.1.3 Financing**

Opportunities for low-income individuals to access finance for the development of rental units remain limited. This is due to such individuals not qualifying for

conventional bank products due to lack of credit records or stable income (Beck et al, 2013). Microfinance has traditionally filled a gap for the market not served by commercial banks by offering non-secured, shorter-duration loans for lower-income households (Beck et al, 2013). Maholtra (2003) found that in different countries across the world, a trend emerged in terms of microfinance institutions providing loans for home improvements and thus; housing microfinance (HMF) emerged as a subsector of microfinance.

HMF provides loans for incremental building or home improvement. Loan amounts are smaller than mortgage loans but larger than microenterprise loans (Ferguson, 2003). Loan terms (between 1 to 8 years) are much shorter than traditional home credits, but longer than microbusiness lending (Ferguson, 2003). HMF is thus an intermediate between traditional mortgages and microfinance.

It is estimated that 10% to 33% of microfinance in South Africa is applied to housing in some form (Gardner, 2008). The microfinance loan is used to finance home improvements or extensions, but not typically used for the development of new housing stock. Home improvement includes a wide range of activities that expands the client's asset base; however the construction of a rental unit is not explicitly mentioned in any of the definitions.

Financing for the construction of small-scale rental units differ from financing for primary dwellings in that units are smaller than a primary dwelling and thus cheaper to construct. Furthermore, as the purpose of the unit is not to serve as the family's primary shelter, it can be constructed incrementally and once completed, can generate an immediate income by being leased out to tenants. Whereas the improvement of a home would increase the property owner's asset base, the construction or improvement of a rental unit would increase the property owner's income base and asset base.

## **1.2 STUDY FOCUS**

### **1.2.1 Problem Statement**

Backyard shacks prevalent in new government-sponsored housing developments is a distinctly South African phenomenon (Lemanski, 2009). Conventional housing finance and government housing delivery systems have consistently failed to meet the housing needs of lower income South Africans (Sisulu, 2005); however the informal market has responded to the housing need. The rate at which new households create informal housing now exceeds the rate of government housing - and infrastructure provision (Durand-Lasserve et al, 2002).

Backyard shacks in formalized areas create a number of problems relating to urban management and public health as a result of illegal services connections. Furthermore, backyard shacks put added pressure on infrastructure systems,

without contributing to the costs of providing such services. Despite these negative outcomes, backyard shacks have enormous potential as a means of densifying existing serviced neighbourhoods and providing small-scale affordable, flexible, decent, intermediate rental accommodation (Urban Landmark, 2012).

South Africa's policy environment has not been successful in unlocking the potential that backyard shack formalization holds, despite benefits of such formalization primarily relating to the achievement of high-level government policy objectives. Government interventions such as the provision of grants and subsidies have resulted in sub-optimal allocation of resources and unintended negative consequences.

Housing Microfinance (HMF) is increasingly viewed as an important tool that can facilitate access to affordable, appropriate shelter for lower-income households (Daphnis and Ferguson, 2004); yet, true large scale lending in HMF is yet to happen. Demand for HMF is still largely unmet and the potential for the industry still remains untapped (Kihato, 2013). HMF can make a significant contribution to facilitate access to affordable and appropriate shelter; however governments play an important role in creating an enabling policy and a regulatory environment for these finance institutions to operate in (Malhotra, 2003). Whilst potential players in the HMF field may be better positioned to intervene in the formalization of backyard shacks by means of providing financing products, they are not incentivized to achieve the high-level government policy objectives that have driven government intervention thus far. This study therefore seeks to

- Identify concerns of potential players in the HMF field if asked to develop a niche loan product targeted at government-sponsored house recipients and used for the purpose of upgrading a backyard shack;
- Identify prerequisites for potential players' involvement in above-mentioned product development.

### **1.2.2 Research Objectives**

HMF Institutions that provide housing finance services to the poor issue loans used for improvements to existing homes and for incremental building (Gardner, 2008). Most of the microfinance loans are used for housing purposes by default and not by design (Gardner, 2008). This study explores the appetite of potential players in the HMF field to develop a niche loan product, targeted at beneficiaries of government-sponsored houses and used to finance the formalization of backyard shacks in government housing projects in urban South Africa. Potential players will be asked to identify concerns and prerequisites for their involvement in developing such a product.

### **1.2.3 Research Questions**

Research questions for potential players in the HMF field in South Africa are structured around the following themes.

**Assuming that product design is flexible, what concerns would you have in terms of developing a niche loan product, targeted at beneficiaries of government-sponsored houses, that can be used to finance the formalization of backyard shacks in government housing projects in urban South Africa?**

- Financial concerns
- Social concerns
- Logistical concerns

**Are there prerequisites for your organization to get involved in the development of the above-mentioned niche loan product?**

- What needs to change?
- What do you think your organization or other organizations need to do differently?

### **1.2.4 Relevance of research**

The prevalence of backyard shacks in RDP housing estates in urban South Africa is indicative of the demand for rental accommodation as well as the failure of existing housing policies to meet the housing demands of the urban poor. HMF is currently very topical in Africa, as is evident by the recently formed African Housing Microfinance Initiative (AHMFI), which aims to grow and support HMF in Africa.

### **1.2.5 Research Ethics**

Due to the sensitive nature of this topic, respondents will not be identified by name, but only identified by organization.

It should be recognized that any topic related to government housing in South Africa is highly politicized. Whilst discussions occurred with local government officials on the topic of this research, these discussions were with officials employed by the same government agency as the author and was not included as part of the sample due to confidentiality - and bias concerns. It was decided to rather use access to this convenience sample of government officials within the author's organization to verify statements made by respondents that were interviewed. Future research suggestions that are made in section 6.4.1 include

having an independent and politically neutral research organization undertake follow-up research involving interviews with government officials.

### **1.2.6 Limitations Of Research**

The research is exploratory and is limited to testing the appetite of potential players in the housing microfinance field to be involved in developing a niche loan product targeting a very specific problem. A qualitative research methodology is used and limitations of such a methodology include a threat to the credibility of the research. The measures to address this threat to the credibility of the research are elaborated on in Section 3.5.2.

### **1.2.7 Research Assumptions**

#### **1.2.7.a) Sufficient demand for the niche loan product exist**

Malhotra (2003) identified client demand for services as a precondition for expanding the reach of housing microfinance. Internationally, the growing portfolios of microfinance institutions attest to the fact that the poor are more concerned about access to credit than the cost of the credit (Malhotra, 2003). Whilst there is sufficient evidence to suggest that this is the case for credit in general, the appetite for credit for a specific purpose (in the case of the research being undertaken, the demand for accessing finance for the formalizing of a backyard shack into an affordable rental unit) is not documented.

A research assumption will be made that sufficient consumer demand exist for a HMF product catering for the formalization of a backyard shack into a rental unit. This assumption can be justified by the prevalence of existing rental units in urban South African centres, albeit that these structures are mostly illegally constructed or informal in nature.

#### **1.2.7.b) Commercial microfinance lenders will not be interested in developing such a niche product**

Microfinance institutions have demonstrated that they can provide financial services to the poor at scale and on commercial terms (Malhotra, 2003). A very preliminary analysis of HMF found that the poor are reliable clients who are willing to pay the full cost for cost-effective services tailored to their needs (Malhorta, 2003). The commercialization of microfinance currently underway could also apply to HMF. This would result in a new set of emerging players including commercial banks, mortgage finance companies and private builders (Malhotra, 2003).

Durand-Lasserve et al (2002) state that there is significant evidence that financial

institutions are reluctant to engage with the low-income section of the South African population and have traditionally shunned this market. As this study focused on beneficiaries of RDP houses, their income needs to be below R3500 per month in order to qualify for the subsidized house. This income group is unlikely to entice commercial banks to issue loans to them.

#### **1.2.7.c) Governments subsidies for the formalization of backyard shacks are not effective**

The government has attempted to develop subsidies for the upgrading of backyard shacks; however most supply-side subsidy schemes are not very effective in terms of achieving production of more low-income rental units for the lower end of the market on a sustainable basis (Urban Landmark, 2012). Rental subsidies or incentives are typically linked to conditions that stipulate minimum standards for the completed units. Subsidies tend to be open-ended and costly to administer (Watson, 2009; Sloman et al, 2000). Social policy objectives of subsidies are often not accomplished or not accomplished at minimum cost due to inefficiency and distortionary effects.

Based on the assumption that resources currently used for subsidies for the upgrading of backyard shacks could be better applied to incentivise better positioned potential players to provide loans for the upgrading of backyard shacks, respondents will be asked to identify prerequisites for their involvement. Such prerequisites could include actions that the government must undertake.

#### **1.2.7.d) The niche product's design will be flexible**

It is assumed that sufficient demand exists for a niche HMF product specifically designed for financing the formalization of backyard shacks in RDP housing projects in urban South Africa. For the purpose of this research, it will be assumed that the conceptual "product" is flexible. It is recognized that loan parameters will need to be developed in further research, however the focus of the research will relate to concerns and prerequisites for considering such a niche loan for product development.

#### **1.2.7.e) Sufficient demand from tenants exist for a more formalized rental unit, even if the rent increases**

Should backyard shack be upgraded, the rent charged to tenants will increase. Whilst the tenant might be willing to accept higher rent charged in line with the improved living conditions in the formalized rental unit, it is accepted that current tenants might not be able to afford the increase and will be displaced by tenants willing and able to pay higher rent. The current low rentals charged by home owners is filling a gap in the market; however it is not certain where the saturation point is in terms of demand for rental above a certain price. This is addressed in 6.4.3 as a future research suggestion relating to the testing of rental demand and price flexibility.

# CHAPTER 2

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## 2. LITERATURE REVIEW

### 2.1 INTRODUCTION

Backyards shacks in government housing projects are a distinctly South African feature (Lemanski, 2009) and are intrinsically linked to the government's housing policy. Backyard shacks reflect the unmet demand for low-income rental units and represents a manifestation of the shortcomings of a government housing policy focused on formality and ownership.

This literature review firstly contextualizes backyard shacks within South Africa's Housing Policy. Thereafter, problems associated with backyard shacks and the potential related to the upgrading and formalization of backyard shacks are discussed. The existing players in this field and the products these players offer to facilitate the upgrading of backyard shacks are presented. Lastly, paradoxes related to incentive and ability in terms of the provision of these products as well as shortcomings of the current situation is explored.

### 2.2 POLICY CONTEXT

South Africa's democratization in 1994 brought a drastic change to housing policy. The Housing White Paper of 1994 outlined a housing strategy based on creating broad-based home-ownership across all income groups (Gardner, 2008). This was to be achieved by introducing a grant for which lower-income households earning less than R3500 per month were eligible. This grant provided a basic 30-40m<sup>2</sup> "minimum standard house" on a serviced site at no cost and with freehold tenure (Gardner, 2008). Such houses were referred to as RDP houses (received by beneficiaries as part of the Reconstruction and Development Programme). This programme was replaced with the Breaking New Ground Policy; however for ease of reading, the term "RDP house" will be used as a reference for any fully government subsidized housing in this research.

Most subsidized housing programmes are only available to South African citizens who have not previously owned a home or benefitted from government assistance and who form part of a 2-member household or have financial dependents.

Whilst the government's fully subsidized housing programmes have been partially successful in terms of scale, the outcomes do not match the volume of low-income shelter needs or the diversity of shelter products, tenures and living environments (Gardner, 2008). Most South African households cannot afford entry-level housing, but earn too much to qualify for subsidized housing

(Gardner, 2008). This leaves 22% of the South African population in the so-called “gap market”- excluded from both state-supported subsidies and the formal housing market (Gardner, 2008).

The Financial Lined Individual Subsidy programme (Flisp) was introduced in 2005 to attempt to extend housing access to those whose earnings exceeded the cut-off for subsidized units but who cannot afford housing in the open market. Flisp links a limited subsidy amount (that reduces with increasing income) to housing purchased using mortgage finance (Gardner, 2008).

The Social Housing Policy (2005) and the Social Housing Act 16 (2008) were developed to contribute to the overall functioning of the rental sub-component of the housing sector. Social housing is defined as a rental or co-operative housing option for low-income persons at a level of scale and built form that requires institutionalized management (Tissington, 2010). The policy has provided subsidy mechanisms that incentives down-market reaching in order to achieve a spread across the monthly household income range of between R1 500 and R7 500. In order to qualify for the capital grant on every unit, a project must have at least 30 percent of the units contributing to what is known as ‘deep down-market reach’ and a cap on maximum rentals (implying a household income of R7 500 per month, which is the top of the income band).

The government’s policy on housing is continuously evolving; with new subsidies being developed and existing subsidies being refined. A plethora of research on the success of government’s housing policies has been published. This research is specifically focused on backyard shacks in fully subsidized housing projects. The literature review therefore does not include a comprehensive review of all Government subsidies, programmes and grants and the discussion above has therefore been limited to programmes specifically applying to the topic of this research.

### **2.2.1 A Response to Insufficient Housing Policies**

A significant post-apartheid housing trend is the emergence of a new supply of backyard shacks in RDP housing areas (Lemanski, 2009). Most backyard shacks comprise a single room in which residents cook, eat, sleep, wash and live; making the quality of the living conditions similar to living in informal settlements (Lemanski, 2009). Despite these living conditions, being dependent on landlords and liable for rent, people prefer to live in backyards shacks due to access to services, location, flexibility and reduced threat of eviction (Lemanski, 2009).

Backyard dwellers have historically been perceived as being marginalised and exploited by cavalier landlords and living in appalling conditions (Lemanski, 2009). Research from the 1990s documents tenant disgruntlement; however from late 1990s, backyard dwellings became a more attractive form of housing. Backyard shacks represented the most common form of accommodation for new

arrivals to urban areas and offered extremely low rents and access to services, with relatively conflict-free and non-exploitive tenant-landlord relationships (Lemanski, 2009).

In the contemporary context of public housing projects, where homeowners are poor, the tenants wield significant financial power. A study that investigated backyard shacks in four subsidized low-cost housing communities in Cape Town found that few of the backyard dwellers were relatives of the dwellers in the main house (Govender et al, 2011). Approximately 28% of main households and 20% backyard shack dwellers received a government social grant. Significantly more of the occupants of the shacks were employed and had higher education status than the occupants of the main houses (Govender et al, 2011). Govender et al (2011) found that the reported incomes of the inhabitants of the main houses were statistically significantly lower than those of the occupants of the shacks. The amount of rent charged by landlords was not exorbitant and constituted a basic service rendered rather than an exploitative one.

The power that tenants wield is equally constrained by their reliance on the landlord for cheap and serviced accommodation (Lemanski, 2009). There is an inherent contradiction in this situation as the persons better able to pay (backyard shack dwellers) are living in poorer housing conditions (Govender et al, 2011). Contrary to initial assumptions, the dependence of landlords on tenants' rent has shifted the power equilibrium to a fairer situation (Durand-Lasserve et al, 2002).

Backyard shacks have historically been overlooked by South African housing policies (Lemanski, 2009). Huchzermeyer (2008) considers informal settlements a response to these conscious government policies focused on eradicating informality. Similarly, the letting of yard space and erection of backyard shacks is a direct response to the failure of the housing policy to realize the poverty of recipients as well as their use and understanding of land and property (Lemanski, 2009). Fully subsidized government housing programmes promotes homeownership above all else and beneficiaries are expected to use the house for living and not for income generation. Lemanski (2009) states that policy-makers perceive the causality between augmented informality and the housing policy as an agency problem related to homeowners' ignorance and ingratitude, rather than being a structural by-product of the government's housing policy. Paradoxically, the housing strategy formalizing residents and land has become the key mechanism for augmenting informal housing (Lemanski, 2009).

One of the unexpected results of the 2011 Census in South Africa was the sharp growth in backyard shacks in the major cities. This is a relatively new social phenomenon whose significance has not been grasped by national or local policy makers and deserves greater attention (<http://www.hsrc.ac.za/en/review/hsrc-review-may-2013/census-2011-reveals-boom-in-backyard-shacks>, accessed on 10-12-2013).

## **2.3 PROBLEMS AND POTENTIALS**

### **2.3.1 Market Failure**

South Africa's state-delivered subsidized housing process that delivers only fully subsidized housing products depresses demand for independent solutions whilst also constraining the potential for combining subsidies with microfinance (Gardner, 2008). The promise of a fully subsidized house crowds out demand for intermediate housing products and is a disincentive for households to invest in housing independently (Gardner, 2008). Furthermore, access to land and housing is entirely mediated by the government's fully subsidized housing programmes, with almost no products available for HMF borrowers to buy (Kihato, 2013).

Private developers cannot produce privately financed houses that are differentiated from the subsidized counterparts to justify the consumer's perceived high price (Gardner, 2008). Subsidies that were developed to incentivize private developers to extend their down-market reach have not succeeded. Outside the full Flisp subsidy eligibility band, housing affordability diminishes substantially. Even the Flisp subsidy is ineffective in improving affordability (Gardner, 2008). Similarly, the social housing subsidies have not incentivized developers. Ongoing management, operations and maintenance costs related to social housing remains a major deterrent for developers to make use of the subsidies (Tissington, 2010). The slow pace of low-income rental housing delivery and the ability of the policy to address the needs of very low-income beneficiaries is of concern (Tissington, 2010).

Due to the lack of affordable available housing many households opt for sub-optimal housing conditions, rather than investing in their own house. The burden of meeting the housing crisis is thus exclusively placed on government, rather than sharing the burden between public and private sectors (Gardner, 2008).

In South Africa, tenure security in urban areas requires formalization of land rights through full formal private tenure and is rarely, if ever, accessible other than through formal housing delivery (Durand-Lasserve et al, 2002). Home ownership can be a powerful weapon in the fight against poverty (Melzer, 2005). For many poor households, their home is their only asset. In an appreciating housing market, growth in the value of this asset can result in wealth accumulation; however asset value is only realizable if the asset is traded (Melzer, 2005). In an environment where housing markets do not function and housing as assets cannot be readily leveraged or sold, increasing access to formal housing and housing finance can perversely increase the burden of poverty (Melzer, 2005).

Legislated minimum standards for a “minimum acceptable house” inhibit the ability of households to develop intermediate housing options and improve these over time (Gardner, 2008). Setting the standard at an unattainable level ignores and criminalises alternative ways to progressively meet the benchmark of minimum housing standards over time (Gardner, 2008). This result in a delivery process for subsidized housing that at current rates of funding cannot meet the needs of inadequately housed South Africans (Gardner, 2008). Demand for financial services will be constrained if the poor are not allowed to build or if they live in fear of their homes being demolished or if financial institutions are restricted by legal constraints (Malhotra, 2003).

### **2.3.2 Urban Management Issues and Public Health Risks**

A study that investigated backyard shacks in four subsidized low-cost housing communities in Cape Town found that backyard dwellers were allowed to use the toilet on the property of landlords and illegal electricity connections were created from the main house to backyard shacks (Govender et al, 2011). Tenants paid the landlord between R20 and R100 per month for water and between R50 to R200 per month for electricity usage (Govender et al, 2011). Only 4% of landlords paid the municipality for their water usage, but all landlords sold water to the backyard dwellers (Govender et al, 2011). Backyard shacks place additional pressure on municipal services, but the financial contribution they make to the landlord does not reach the City.

The strain imposed on municipal services by informal densification of unofficial backyard shacks was found to create unintended public health risks (Govender et al, 2011). An analysis of burn injuries in Cape Town showed that shack fire burns were the second most frequent reason for admission to a Burns Unit in a secondary hospital in Cape Town (Govender et al, 2011). Illegal electrical connections to backyard shacks that are made of flimsy materials posed increased fire risks (Govender et al, 2011).

### **2.3.3 Addressing a demand for affordable rental stock**

The government’s housing process is constrained by public budgets and capacity limitations and the rate at which new households create informal housing is greater than the rate of housing and infrastructure provision (Durand-Lasserve et al, 2002).

Two thirds of households forming part of the municipal housing backlog in South Africa are either one or two member households (Urban Landmark, 2012). The RDP house at 30m<sup>2</sup> is often too small to accommodate an entire family and the roll-out of such subsidized houses has precipitated an artificial split of households into multiple units (Melzer, 2005). Although some of these households exist only because they had to split from a bigger household due to inadequate accommodation, many smaller households came into being because

of demographic trends. Such trends include an increase in the number of singles, unmarried people, students, widows and widowers, temporary migrants, young couples, couples without children, same-sex partners and single parents (Urban Landmark, 2012).

Intermediate-sized accommodation such as single rooms, multiple rooms for rental, smaller units specifically designed for future expansion, second accommodation units, tenants or boarding houses could better suit a large proportion of the currently un-housed households (Gardner, 2008).

Moving away from the provision of low-density subsidized houses as the minimal acceptable norm for subsidized accommodation creates the opportunity for a wider variety of more appropriately urban accommodation forms to develop (Gardner, 2008). Facilitating the expansion of the affordable rental market could provide an alternative for individuals who are currently living in informal areas without access to basic services such as water and sanitation.

#### **2.3.4 Generating increased income and asset value for landlords**

Recipients of RDP houses find themselves in a precarious situation. Whilst they have been lucky in terms of receiving a house, many families are still jobless, with no income to enable them to maintain their newly acquired asset. The lack of education among adults in the Govender study contributed to the homeowners' lack of knowledge on how to maintain their new home; many being unable to afford the repairs or the cleaning materials required to keep the home clean (Govender et al, 2011).

Lemanski (2009) found that the government's housing policy of home-ownership only works because backyard dwellings provide sufficient income for poor homeowners to cover the expenses of formal living. Given the poverty and unemployment in public housing projects, it should not be surprising that residents use their sole asset to generate income (Lemanski, 2009). The post-apartheid provision of state-funded housing for the poor has created a new class of cash-poor homeowners who are dependent on income from backyard dwellers' rent (Lemanski, 2009). To be eligible for a RDP house, a household must earn below R3500 per month, although most recipients earn below R1500 per month (Lemanski, 2009). The shift from informal to formalized home ownership can add significantly to a household's non - discretionary monthly expenditure (Melzer, 2005). Additional costs relating to homeownership, such as paying council rates, electricity, water and purchasing furniture is unsustainable for many households.

For small-scale households with an income below R1500 / month, the rental income they will receive from a backyard shack will comprise almost one third of their household income (Lemanski, 2009). This rental income forms the economic backbone of the landlord's household income, rather than an additional

form of income (Lemanski, 2009). Ironically, in a post-apartheid state housing project, the poverty that gave a household eligibility for RDP homeownership is the same factor that forces them to invite informal housing into their yards (Lemanski, 2009).

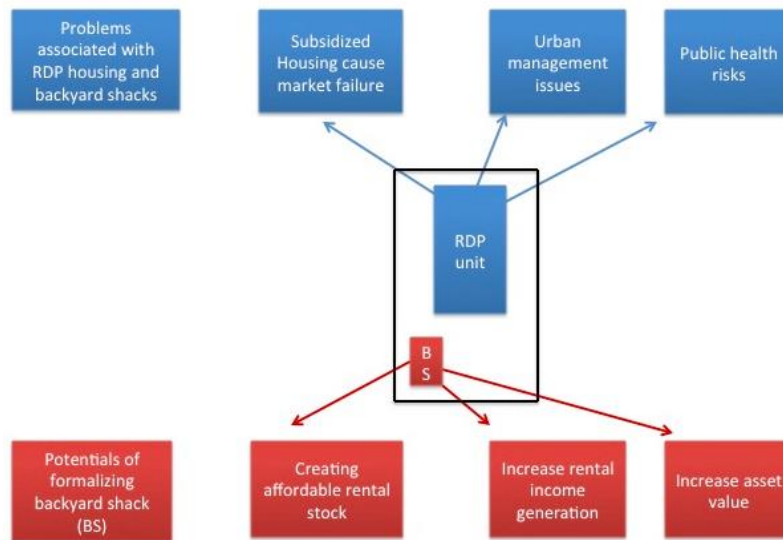


Figure 1<sup>1</sup>: Problems and potentials

## 2.4 THE PLAYERS AND PRODUCTS

As the Housing Microfinance sector increasingly becomes an important investment destination in Africa, more funding is coming on-stream in the form of grants, loans, equity and technical support (Kihato, 2013). Investment into HMF lending operations comes from a variety of sources and with a variety of objectives. Maholtra (2003) identified a number of preconditions for expanding the reach of HMF, including joint ventures between housing institutions and financial institutions, the entry of traditional commercial banks, credit unions and private developers as well as the need for product innovation in community-led, low cost housing construction at scale. Gardner (2008) predicts that HMF in South Africa will grow through cooperation and competition between players in the sector.

In addition to HMF, there are other products that could also be used to upgrade backyard shacks such as subsidies or mortgage loans. This section will offer an

<sup>1</sup> The figure represents the author's summarized view of the various literature sources discussed above, inclusive of the unpublished discussion by academics on <http://www.hsrb.ac.za/en/review/hsrb-review-may-2013/census-2011-reveals-boom-in-backyard-shacks>, accessed on 10-12-2013.

overview of the players in this arena, along with the products on offer.

#### **2.4.1 The government offering subsidies**

The economic rationale of using government subsidies relate to offsetting market imperfections, exploiting economies of scale in production and meeting social policy objectives (Schwartz et al, 1999).

##### **2.4.1 a) Subsidy to encourage the provision of lower-income housing loans**

South Africa is unique in that there is active government DFI's with mandates to encourage housing lending to lower income segments of the population. The National Housing Finance Corporation (NHFC) provides wholesale finance for on-lending to specialist housing micro lenders and specialist housing microlenders (Kihato, 2013).

##### **2.4.1 b) Subsidy to formalize backyard shacks**

The Backyard Rental Programme in Gauteng (a province in South Africa) provided a subsidy for the supply of affordable rental units. The objective of the Backyard Rental Programme was to eradicate the informal backyard structures and replace them with structures that are compliant with the Gauteng Department of Housing's standards (Watson, 2009). The programme provided an Affordable Rental Accommodation Grant to qualifying landlords to repair or rebuild backyard accommodation. The subsidy would therefore lower the cost of formalizing an informal, existing second dwelling. Conditions were attached to the grant requiring the beneficiary to stay in the property for five years before selling and not allowing any further construction of shacks in the backyard in order to regulate and enhance the backyard rental environment (Watson, 2009; Urban Landmark, 2012).

Capital subsidies, such as the Gauteng Programme, are less transparent and make accountability of the conditions attached to the subsidy difficult. Certain landlords participating in the Gauteng programme converted upgraded rooms to more lucrative business premise (Urban Landmark, 2012); thereby decreasing the available stock of rental units. As the upgrades made as part of the Gauteng programme resulted in a reduction in the number of rentable rooms per plot, landlords had to increase rent and due to a net loss of housing opportunities. This resulted in poorer tenants being displaced (Urban Landmark, 2012). The Gauteng programme suffered from production inefficiency as the 800 units that were delivered through this programme could have been delivered at a lower cost.

##### **2.4.1 c) Subsidies to incentivize private developers and financiers**

Government subsidies such as Flisp and the Social Housing Policy (2005) and the Social Housing Act 16 (2008) were developed to contribute to the overall functioning of the housing sector and to incentivize developers' down-market reach. These subsidies and policies have not succeeded in encouraging the private sector to provide mortgages for households in the gap market (FFC, 2013).

#### **2.4.2 Institutions and developers accessing housing subsidies**

Social housing institutions (SHIs) refer to organizations that administer social housing projects. The SHIs have developed social housing stock using the institutional subsidy and loan funding from the National Housing Finance Corporation (NHFC) and have relied on donor funding and local authority grant funding to cover set-up and operational costs. This system has resulted in an unsustainable situation where the majority of SHIs depend on donor funding in addition to the government's institutional subsidy in the form of a capital grant (Tissington, 2010).

#### **2.4.3 Regulated lenders**

Regulated lenders encompass first and second tier lenders who are governed by the National Credit Act (NCA). The NCA dictates the maximum interest rate and initiation fee that may be charged, but does not dictate the size and term of the loan (Gardner, 2008). The NCA makes provision for "developmental credit" as a subset of microfinance. This permits second tier lenders such as MFIs to charge an interest rate premium and higher origination fee for the provision of microloans for educational and housing purposes. This is due to the more complex nature of granting these loans (Gardner, 2008). Despite this concession, most HMFs still price their loans within the normal interest rate and fee caps in order to remain competitive (Gardner, 2008).

##### **2.4.3 a) Commercial banks offering mortgages / secured lending**

Commercial banks are considered as first tier lenders and are regulated and registered as banks under the Banks Act. This category of lenders is commercially orientated and can raise capital from deposits (Gardner, 2008). Conventional housing finance is generally intended for the purchase of a complete housing unit or construction of such a housing unit (Smets, 2005). Mortgage loans have 10–30 year loan terms, a minimum and regular income requirement and require a registered title deed to consider an immovable tangible asset as collateral for the loan. Repayment of the loan is generally fixed in equal periodic payments. Such financial terms and conditions require a regular income of a sufficient size, the availability of personal resources for down payments and collateral (Smets, 2005).

Institutions offering sizable long-term loans have to face a high risk of default, which leads many financial institutions to refrain from providing housing finance. Due to complex procedures and insufficient financial resources of the poor, the inadequacy and sparse coverage of the banking network and the inadequacy of housing standards prescribed by banks for eligibility for lending, conventional housing finance does not reach the urban poor adequately (Smets, 2005). The urban poor generally lack a regular and high enough income and security to pledge, to render mortgage loans a viable option (Smets, 2005).

Mortgage finance is generally granted to households earning more than R15 000 per month and mortgage finance to households with an income below R7500 is almost non-existent (FFC, 2013). Most of the poor are considered high-risk borrowers, which is reflected in the high interest rates they are charged (Smets, 2005).

According to the household access credit frontier, households with a monthly income of between R3500 and R7500 can qualify for a mortgage bond between R140 000 and R300000, depending on the interest rate and creditworthiness. The National Credit Regulator found that of the total value of mortgage bonds granted, less than 10% are below R350 000. Even when the poor can obtain a housing loan, they face problems of access due to cultural, informational and physical barriers (Smets, 2005). FCF (2013) states that banks are either reluctant to fund affordable properties or the supply of affordable homes are insufficient.

#### **2.4.3 b) MFI's offering microloans**

MFI's are considered as second tier lenders and are regulated as non-banks via the National Credit Act. MFI's are generally less commercially orientated than first tier lenders (Gardner, 2008). The lending activities of less commercially orientated organizations offer an important contribution to HMF practice in their willingness to take on higher risks, as well as engage with downstream processes such as the house building process itself (Kihato, 2013).

Microfinance loans are non-secured, shorter-duration loans for lower-income households (Beck et al, 2013). Microfinance is a useful financial instrument for construction, extension and improvement of dwellings units (Gardner, 2008).

HMF is a subset of microfinance that is typically used for improvement and not for building or purchasing a new home (Maholtra, 2003). It is an alternative housing finance option for those who do not wish to or are unable to access housing using mortgage finance or secured finance (Gardner, 2008). Housing loans are generally larger in size (as reflected in a longer repayment period and a higher level of risk) compared with microfinance loans for income generation (Smets, 2005). Such loans have longer terms, larger amounts, lower interest rates, adapted loan appraisal techniques and no differentiated collateral or service delivery channel (Malhotra, 2003).

Much of their investment in HMF has been linked to general microfinance lending, with organizations they have invested in branching off into HMF (Gardner, 2008). There are not many housing-specific HMFs in South Africa; with the majority of players providing housing-specific products within a wider bouquet of financial services offerings such as insurance and savings products (Gardner, 2008). Previous housing-specific microlenders struggle to source credit-worthy clients. This has led to such lenders diversifying their product ranges within existing markets and expanding to new markets such as the credit and debit markets or to provide financial services and insurance products (Gardner, 2008).

#### **2.4.3 c) Savings-backed loans**

Gardner (2008) found that there is only one organization in South Africa that has successfully combined HMF with housing subsidies, namely the Kuyasa fund. The fund links its loans to beneficiaries of housing subsidies and to individuals who have already received their subsidy homes but wish to extend or improve the existing structure. Kuyasa's investors (which include local funds, pensions and government development funding institutions) provide grants and debt for onward lending or guarantees and equity (Kihato, 2013).

The fund's lending methodology is based on clients demonstrating a savings record prior to being granted finance. The savings-backed housing microloan is preceded by a specified savings period (3-6 months) to demonstrate the ability to repay (Gardner, 2008).

#### **2.4.3 d) Hybrids of retailers and banks offering development credit**

Low-income groups account for a significant proportion of unsecured lending; however it is not clear to what extent individuals use unsecured lending to contribute to their housing needs (FFC, 2013). Whilst retail stores have traditionally provided direct credit, such practices are not common in the building trades industry (Gardner, 2008). Unfortunately, despite household indebtedness levels reaching new highs, little of the credit is used for long-term assets and most is being used as consumer credit (Gardner, 2008).

A new emergent form of credit is developmental credit that is provided for a specific purpose, such as for the purchasing of building material (Gardner, 2008). Certain retail chains have forged relationships with registered credit providers to originate credit within their stores. An example of such an arrangement is Nedbank (a first tier financial institution) and Retail Credit Solutions that provide credit to customers of Cashbuild, one of South Africa's largest building material supply chains (Gardner, 2008).

#### **2.4.4 Unregulated lenders offering personal savings on a rotational basis**

Third tier lenders are generally unregulated HMF players who fall outside of the formal system (Gardner, 2008). This category includes mutual entities and community based shelter funds, informal moneylenders and informal and locally established saving groups (Gardner, 2008). Examples in this category include rotating savings and credit cooperatives (ROSCAS or stokvels) and other informal lenders (Kihato, 2013).

Informal loans, which are generally small in both size and repayment duration and which are provided by kin or informal moneylenders, are generally used for emergency expenses (Gardner, 2008). Approximately only 2% of informal loans were used for housing improvements (Gardner, 2008).

## **2.5 PARADOXES**

### **2.5.1 The government's incentive but inability to intervene**

Historically, backyard shacks represented the antithesis of the government's policy, which emphasized homeownership and the eradication of informality and were either ignored or demolished (Lemanski, 2009). Since 2004, the Government has started to recognize the positive contribution of backyard shacks in terms of facilitating a rental sector (Lemanski, 2009).

The government has spent a significant amount of public funds on the provision of RDP houses. The return on this massive public investment and the continued sustainability of the provision thereof has been questionable. The condition of the state-funded RDP houses is poor due to homeowners' limited ability to maintain the infrastructure of their homes (Govender et al, 2011). Backyard shacks in RDP projects can lead to urban management issues that further deteriorate the condition of the RDP houses. The Government therefore has the incentive to protect its investment in RDP housing provision by facilitating the upgrading of backyard shacks.

The sprawling, low density and segregated land use patterns in South African cities are both inefficient and highly inequitable as such land use patterns impose significant costs on poor households (ICDG, 2013; NDP, 2012). Public investments since 1994 have largely reinforced this apartheid spatial form and these land use patterns are perpetuated in RDP housing projects. This imposes significant costs on the fiscus and on poor households (ICG, 2013). The creation of a small-scale rental market could densify existing settlements, which has economic enefits such as utilisation of infrastructure investment and reduced pressure on transportation infrastructure (Urban Landmark, 2012).

The promotion of rental housing through formalization of backyard shacks could create jobs through both horizontal and vertical supply chains, including jobs in areas such as raw material production, cement production, timber, and aggregates (Urban Landmark, 2012). Many of these jobs could be low skilled and can come on-stream rapidly (Beck et al, 2013). Furthermore, small-scale rentals

could encourage private sector activities through the provision of a steady income for landlords through receiving rent (Urban Landmark, 2012). Therefore, it is clear that government has incentive to encourage the formalization of backyard shacks.

The majority of backyard shacks interventions related to the provision of subsidies for the upgrading of informally constructed rental units (Urban Landmark, 2012). Governments intervene in markets, inter alia, to attain greater equity. From a social justice perspective, and given South Africa's housing backlog, it is unclear how the allocation of a second subsidy to a household that had already received a subsidized house is justified, especially when the allocation of a second subsidy is at the expense of those individuals still waiting for a first subsidy (including tenants who were on the housing waiting list) (Urban Landmark, 2012).

Schwartz et al (1999) states that subsidies can only be justified under very specific circumstances and that in most cases, it would be difficult to justify subsidies on purely economic grounds. Subsidy programmes are often costly in terms of their fiscal burdens and distortions caused in resource allocation. Subsidies are also not effective in reaching the intended target group of beneficiaries as governments have insufficient information to target the beneficiaries efficiently (Schwartz et al, 1999). Providing subsidies in-kind as opposed to in cash may help to target more efficiently the people with high needs (Schwartz et al, 1999).

The FFC (2013) recommends that the government invest more resources in funding or scenarios that are likely to stimulate additional funding from the private sector and household contributions. This includes investment in the upgrading of backyard rentals (FFC, 2013).

### **2.5.2 Private sector's ability but disincentive to intervene**

There has been considerable interest in HMF from commercial - and microfinance banks, with a steady trickle of new commercial entrants into African HMF (Kihato, 2013). Innovations in providing loans on commercial terms to poor people are emerging predominantly from private financial institutions that originated as microfinance institutions (Malhotra, 2003). Players include private commercial banks, credit unions, non-bank financial intermediaries, housing finance companies and non-government organizations (Malhotra, 2003).

There has been increased competition among these organizations to grow market share and tap into rising income levels of the growing middle class in many African countries (Kihato, 2013). Such lenders see HMF as a potential area for growth (Kihato, 2013). Banks, microfinance banks and general microfinance lenders continue to introduce HMF products within their lending portfolios (Kihato, 2013). Players across the microfinance spectrum have demonstrated an

ability to rapidly develop and implement new microfinance products to respond to market demand (Gardner, 2008).

There has been a decline in some commercial lending activities, due to the constant need for engagement with the government on critical issues around land administration, management and provision of infrastructure (Kihato, 2013). These challenges will remain hurdles that need to be overcome, given that HMF is intertwined with the housing process (Kihato, 2013).

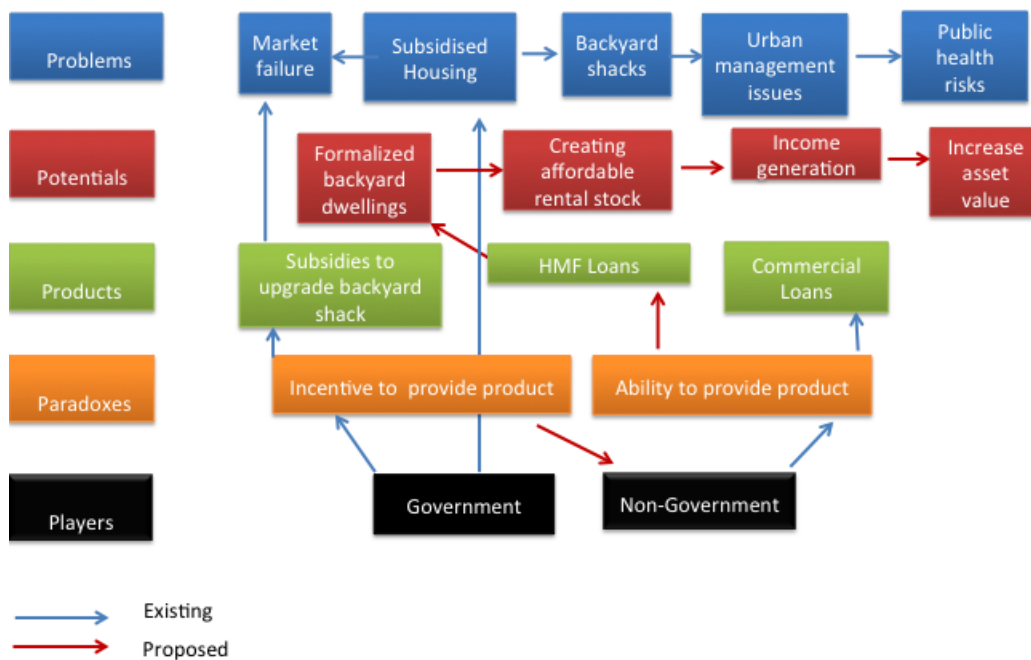


Figure 2<sup>2</sup>: The dichotomy between the government’s incentive and the private sector’s ability to intervene

## 2.6 CONCERNS REGARDING THE CURRENT SITUATION

This section highlights the issues with the status quo, which includes the questionable sustainability of public finance, the issues related to government policy and social justice implications of formalizing backyard shacks.

<sup>2</sup> The figure represents the author’s summarized view of the various literature sources discussed in this chapter.

### **2.6.1 Unsustainable Public Finance**

Fiscal policy towards metropolitan municipalities has evolved considerably since the restructuring of the South African local government in 2000. There has been strong real growth in transfers to metropolitan municipalities, leading to growing grant dependence (ICDG, 2013). Most grant programmes provides capital budget support to metropolitan areas such as Cape Town and are focussed on physical outputs (ICDS, 2013). This focus of grants often resulted in the cumulative effects of these investments being sub-optimal, or no more than the sum of their parts (ICDG, 2013). Identifiable gaps in the funding framework emerge from, inter alia, medium term spending pressures created by current investment programmes such as property rates rebates and free basic services for public housing projects (ICDG, 2013).

The current budget of the City of Cape Town for 2013/14 provides free basic services for properties valued at less than R400 000 and for households with a gross monthly income of R3000 or below (City of Cape Town, 2013). Furthermore, there is a 75% rates rebate for household incomes between R3 500 and R4 000 (City of Cape Town, 2013), which is generally the income band of RDP recipients. When consumption of these free services effectively doubles due to backyard shacks, pressure is placed on the systems.

### **2.6.2 Lack of acceptance of incremental solutions**

Whilst the effectiveness of HMF as a facilitator of home-building activities is well established, HMF in South Africa is effectively excluded from new housing development processes (Gardner, 2008). Gardner (2008) states that the most fundamental blockage to HMF as a viable component of housing delivery stem from political, policy and regulatory constraints in the housing sector itself. A housing programme is required that combines individual resources, subsidies and microfinance to build low-income households' effective demand over time through incremental building methodologies (Gardner, 2008).

South Africa's policy environment does not yet facilitate an incremental housing delivery process (Gardner, 2008). Seeking affordable shelter solutions in South Africa from housing finance will require a concerted effort to implement more appropriate human settlement development systems with more appropriate housing development and subsidy approaches and standards (Gardner, 2008).

### **2.6.3 Social Justice Issues**

Whilst this research is not focused on the social sciences, it is important to recognize the social impacts of intervening in the formalization of backyard shacks. The issues around social justice will not be resolved as part of this investigation; however the author considers it prudent to flag unresolved social

justice issues and state her ethical and philosophical position.

Taking a social policy approach to the problem of backyard shacks would involve protecting the most vulnerable individuals from the market forces at play (Huchzermeyer, 2008). The provision of upgrading subsidies to landlords to formalize informal backyard shacks has in many cases jeopardized tenants' access to affordable accommodation. Any government small-scale rental strategy that deals directly with de-densifying, improving or gentrifying standards in existing areas, will interfere in the fragile existing small-scale rental sub-sector (Urban Landmark, 2012). Such a strategy would upset the intricate supply-and-demand patterns. This can lead to the displacement of the poorest and most vulnerable households into even poorer conditions and result in a loss of accommodation opportunities. Middle-income tenants and landlords usually emerge as the major beneficiaries and therefore any supply-side subsidies must be accompanied by other housing stock being made available to low rent-paying tenants displaced in favour of higher rent-paying tenants (Watson, 2009).

Watson (2009) states that whilst it is honourable to pursue the upgrading of the living environments offered by low-income rentals such as backyard shacks, this objective cannot be justified when the upgrading results in the displacement of the poor. Any scheme needs to be extremely well designed to ensure delivery of "smart" subsidies that target the right population and provide the right incentive structure (Beck et al, 2013); however this is difficult to achieve. Watson (2009) states that the only socially justifiable objective is to remove major obstacles to low-income rental units as a form of shelter for the poor in a manner that avoids major health and safety impacts.

The author accepts informality as a legitimate response to current housing problems and an inevitable component of growing urban cities in the third world. The author questions the appropriateness of the provision of a suburban-styled subsidized house as a form of housing delivery in South Africa. Densification by means of backyard dwellings (whether informal or formal in nature) could assist in creating a more equitable city and result in a more efficient use of space and services. The author would hope that more recipients of RDP houses would densify by means of constructing a backyard shack.

The objective of this study is not to eradicate informality or to better the socio-economic position of the RDP house recipient. Whilst the displacement of the poor is a legitimate concern, it is questionable whether this negative consequence of intervention in the informal rental market justifies no intervention at all as not intervening in the current situation would also result in social consequences. Currently, neither tenants nor homeowners of RDP houses are contributing to the City's services, despite tenants paying a fee to homeowners for the utilization of services the homeowner receives for free. From a public finance perspective, it is therefore important to "harvest" some form of contribution from those using services. Not doing so will impact on the City's ability to provide free services to other communities who are equally deserving of

receiving free services.

## 2.7 CONCLUSION

Backyard shacks represent many contradictions. It provides less comfortable living than RDP homes, yet rent-paying backyard tenants are generally better off financially than their landlords living in RDP houses. These contradictions are largely due to the government's subsidized housing policy, which provides free houses to the poor and distorts the low-income housing market. The government's responses to Backyard Shacks were investigated and most subsidies and government programmes were found to have unintended negative consequences, depress the market or resulted in unsustainable and inefficient outcomes. The government's actions thus have far have not exploited the potential that backyard shack formalization holds such as creating affordable rental stock. The literature review found that backyard shacks deserves much greater attention from policy makers (<http://www.hsrc.ac.za/en/review/hsrc-review-may-2013/census-2011-reveals-boom-in-backyard-shacks>, accessed on 10-12-2013).

From the literature review, it is clear that there is interest in housing microfinance in general from commercial players who do not want to miss out on growing market share. A disincentive for such players is the engagement required with the housing process. There are not many existing housing-specific HMFs in South Africa; with the majority of players providing housing-specific products within a wider bouquet of financial services offerings (Gardner, 2008).

The product that closest resembles the suggested niche loan for upgrading backyard shacks (as proposed by this research) is the Kuyasa Fund's savings-backed loan. The Kuyasa Fund is a not for profit organization that is highly subsidized by donor funds and government capital and is a good example of the government supporting an organization that is successfully achieving high-level government objectives.

Gardner (2008) predicts that large banks will forge relationships with niche housing microlenders to build capacity in the sector. This is already underway, as is evident by the talks between Absa (a first tier commercial lender) and the Kuyasa Fund (Gardner, 2008).

## CHAPTER 3

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### 3. RESEARCH DESIGN AND METHODOLOGY

#### 3.1 INTRODUCTION

This chapter discusses the research design and methodology. An evaluation of the sources is presented and the methods used to increase reliability and validity are discussed.

#### 3.2 RESEARCH STRATEGY

In order to find out possible answers to the research questions, it is necessary to design a research strategy containing methods and tools that are relevant to accomplish the research. The research strategy for this thesis began by gathering and studying background information on the topic. This informed the research questions and the design of the methodology.

The results from the primary and the secondary data collected were analyzed and discussed in order to identify the most important results. Conclusions were drawn based on the results associated to the research questions.

#### 3.3 RESEARCH METHODS

One of the fundamental decisions to make when developing a research approach relates to whether quantitative, qualitative or a mix of both quantitative and qualitative research will be conducted. The preference of quantitative versus qualitative research methodologies depend on philosophical issues related to the question of ontology (the nature of reality) and epistemology (the nature of knowledge) (Tuli, 2010). A quantitative methodology is underpinned by a positivist research paradigm that contains an objectivist nature of reality and empiricist nature of knowledge; whereas a qualitative methodology is underpinned by a constructionalist nature of reality and an interpretivist nature of knowledge (Tuli, 2010).

The data collection techniques of quantitative methodology focus on gathering data in the form of numbers in order to generate quantitative evidence. The emphasis is on measuring variables and testing hypotheses that are linked to general causal explanations (Tuli, 2010). In the case of this study, very little, if any, research has been conducted on the topic. Thus there are no developed hypotheses to test and no available data; rendering a quantitative methodology inappropriate. Due to the lack of research on the topic, exploratory research was undertaken and a deductive research approach was employed. Qualitative research tools are often used in exploratory research, as the research tools are

more unstructured, flexible and diagnostic than quantitative research tools (Du Plessis et al, 2007).

A qualitative methodology assumes that meaning is embedded in the participants' experiences and that this meaning is mediated through the researcher's perceptions (Tuli, 2010). The objective of the research was to test the appetite of potential players in the field with regards to the potential of developing a niche loan product for the formalization of backyard shacks in RDP housing projects in urban South Africa.

The research strategy involved interviewing employees of different organizations. The data generated was based on the experience that recipients have in working with products or customers that shared some resemblance to the proposed niche loan product or the intended end-user.

### **3.4 RESEARCH DESIGN**

#### **3.4.1 Data collection**

Primary data is information that the researcher gathers on his own, whilst secondary data refers to the data such as literature, documents and articles that is collected by other researchers and institutions (Bryman and Bell, 2007). In this research, both primary and secondary data was collected. Secondary data was collected from books, scientific articles, company reports and internet sources, in order to obtain insight in the problem of backyard shacks and to help identify respondents and frame research questions. This data was critically evaluated and used to support the theoretical as well as methodological part of the thesis.

#### **3.4.2 Instruments: In-depth Interview**

Qualitative interviews were used to collect primary data. Qualitative interviewing differs from interviewing in quantitative research, in that the interviewing is generally much less structured (Bryman and Bell, 2007). The in-depth interview can be used as an intensive and indirect research tool for revealing subjective, underlying motives and is a qualitative measuring instrument geared to obtaining more insight into a specific issue. Furthermore, qualitative interviewing is usually seen as being flexible and the interviewer is able to adjust and respond to the interviewee. The interviewer is able to depart from any schedule that is being utilized, new questions may arise due to respondent's replies and the order of questions may be revised (Bryman and Bell, 2007). There is also a greater focus on the respondent's point of view and detailed and rich answers are desired from the interviewee.

Qualitative interviewing can consist of unstructured or semi-structured interviewing. During an unstructured interview, the respondent talks freely while

a semi-structured interview follow a checklist of issues and questions that the researcher wish to cover during the session (Bryman and Bell, 2007). Semi-structure interviews provide the opportunity to regulate the order of the questions and the respondents have the possibility to expand their ideas and speak in great detail about diverse subjects.

Given that the respondents represented different types of organizations and had different professional and academic backgrounds, the semi-structured interview was considered most appropriate, as there was no set of questions that all respondents would have been able to answer. The semi-structured interviews encouraged the interviewees to freely respond to open-ended questions that allowed the interviewer to adjust questions depending on the attributes of the specific organization. The interviewer followed up with clarifying questions.

Qualitative interviews with open-ended questions tend to be subjective, as it is “flavoured” by the interest and opinions of the interviewer. Whilst semi-structured interviews are organized in terms of what issue will be discussed during the interview, follow-up questions depend on the opinions of the interviewer.

### **3.4.3 Administration**

Due to the heterogeneous nature of the respondents and their different academic backgrounds and specialist fields, the author provided background information to recipients prior to the interview. This information explained the broader context of the research and was intended to sensitize respondents with a financial background to the social and policy side of the topic and vice versa.

The author conducted the in-depth interviews. The interviews commenced by the author explaining the purpose of the research, after which respondents were informed that they may leave the interview at any stage, should they feel uncomfortable with any questions asked, providing information or the discussion in general.

As noted in the Ethical Considerations in Chapter 1, any topic related to housing in South Africa is highly political. Due to the sensitive nature of this topic, respondents were not identified by name, but only identified by organization.

### **3.4.4 Sample and respondents**

Qualitative research, which stresses in-depth investigation in a small number of communities, uses purposive sampling as opposed to random sampling (Bowen, 2005). The emphasis is on quality rather than quantity and to become “saturated” with information on the topic (Padgett, 1998).

A non-probability convenience sample was used to identify potential players in the HMF field. Organizations with experience in a certain component of the proposed niche loan were identified. This included organizations with experience in working with

- a similar client profile (RDP recipients with a monthly income below R3500 per month);
- a similar type of loan guarantee (mortgage-backed);
- a similar loan repayment model (rental collection).

These respondents were not solely focused on HMF, but had potential to expand into that field. The identified participants were approached via e-mail and were asked if they would be willing to participate in the study. The request for an interview was sent to the highest person in the organization's hierarchy (Directorate level) and was either responded to at that level or delegated down to a lower tier in the corporate hierarchy. All respondents were employed at senior management level or higher. The importance of interviewing the right person who has a central position within the organization was crucial, as it limits the risk of misrepresentations due to a lack of knowledge and increases the accuracy of the answers.

A snowball approach was used where individuals who were interviewed were asked to recommend other potential respondents that resulted in the inclusion of a Social Housing Institution within the sample. The in-depth interviews took place in Cape Town and Port Elizabeth.

The respondents were

- Masisizane Fund
- Development Impact Fund
- A mortgage lender that did not wish to be named
- Imizi Housing Institution

The respondents represented non-profit organizations, subsidiary of formal financiers focused on SRI, an organizations specializing in mortgage lending and a social housing institution.

The literature review found that the loan offered by the Kuyasa fund closets resembled the niche loan proposed by this research. The Kuyasa Fund is therefore considered as an established and existing player in the HMF field and is not included in the sample, which consists of potential players.

The literature review found that backyard shacks are intrinsically linked to government policies in housing. Although the government was included as an

existing player in the literature review, it was decided to exclude the government as a potential player. The products currently offered by the government (such as subsidies and grants) were found to be inefficient. Whilst the government could be considered as a potential player in terms of providing support to the development of a niche loan product, such support is likely to be indirect.

Whilst discussions occurred with local government officials on the topic of this research, these discussions were with officials employed by the same government agency as the author. These discussions were considered as not being appropriate for consideration as in-depth interviews to due bias and confidentiality concerns. As the author had access to a convenience sample of government officials, it was decided to use such discussions with government officials as a means of verifying statements made by respondents that were included in the sample.

### **3.5 RESEARCH CRITERIA**

#### **3.5.1 Credibility of research**

Validity and reliability are the criteria used to establish the credibility of quantitative research (Golafshani, 2003). Joppe (2000) defines reliability as the extent to which results are consistent over time and an accurate representation of the total population under study. If the results of a study can be reproduced under a similar methodology, then the research instrument is considered to be reliable. Validity determines whether the research truly measures that which it was intended to measure or how truthful the research results are (Joppe, 2000).

The credibility of quantitative research depends on instrument construction; however in qualitative research there is no instrument construction as the researcher is the instrument (Golafshani, 2003). The credibility of a qualitative research therefore depends on the ability and effort of the researcher (Golafshani, 2003). Terms such as reliability and validity have to reconceptualized in the qualitative paradigm and can be substituted with terms such as trustworthiness, rigor and quality, credibility, neutrality or confirmability, consistency or dependability and applicability or transferability (Golafshani, 2003).

A major potential threat to trustworthiness in this research was identified as respondents' biases. Respondents may be inclined to give answers that they think the researcher wants to hear and present certain situations more positively or negatively than the manner in which the interviewee actually perceives them (Bowen, 2005).

#### **3.5.2 Steps taken to avoid or mitigate bias**

The author is aware that moderators can also introduce serious biases into interviews by changing topics too rapidly, failing to cover certain topic areas and encouraging certain answers (Du Plessis et al, 2007). Maholtra (1996) states that moderators must be sensitive, flexible, encouraging and involved, as well as being able to assume misunderstanding so as to encourage explanations and to be kind but firm. The author took great care not to introduce biases and stated upfront that due to the exploratory nature of the research, there were no preferable outcomes of this research and that the objective was to simply gather information.

It was noted that the heterogeneous nature of the respondents and their different academic backgrounds and specialist fields could introduce biases towards their field of expertise. Respondents were asked at the start of the interview to identify themselves as experts in the financial, social or policy field in order to contextualize their responses. As noted in section 3.4.3, the author provided background information to recipients prior to the interview in order to sensitize respondents with a financial background to the social and policy side of the topic and vice versa.

Due to the small sample size, there was a need to test the validity of respondents' statements that were considered to be potentially subjective. As the author is employed by a government organization, she had access to a convenience sample of officials with experience in government housing. Whilst these government officials were not included in the formal sample (due to concerns around bias and confidentiality), the author asked such officials to comment on the validity of responses related to government housing.

### **3.6 DATA ANALYSIS**

The analysis of interview transcripts was based on an inductive approach geared to identifying patterns in the data by means of thematic codes. Inductive analysis allowed for patterns, themes, and categories of analysis to emerge from the data; rather than being imposed on them prior to data collection and analysis (Patton, 1980).

Data analysis from the interviews comprised content analysis of the transcripts recorded during the interview sessions. Themes were identified for each question. These themes were categorized into meaningful groups of concerns, ideas, attitudes and feelings. Once the categories were established, content of the interviews were arranged into different categories for further comparison.

Secondary data available for the Kuyasa fund was presented in Chapter 4, to enable a comparison of the potential players against the Kuyasa Fund as part of the analysis.

The author engaged informally with government officials that did not meet the criteria for inclusion in the sample, but who had expert knowledge related to the housing field. These individuals were asked to comment on the validity of statements relating to their field of expertise.

### **3.7 EXPECTED RESULTS**

It was expected that potential players in the HMF who are more commercially orientated would be less interested in being involved in the development of a niche loan than organizations with a social objective. It was also expected that respondents would be critical of certain government interventions related to housing and would identify a revised role for government or financial support from government as part of the prerequisites for getting involved in developing a niche loan.

# CHAPTER 4

## 4. FINDINGS

### 4.1 INTRODUCTION

In Chapter 1, the concept of the “potential players” was introduced and was defined as those parties that could offer the products to exploit the potential that the upgrading of backyard shacks hold. Chapter 2 provided an introduction to the existing players (such as the Kuyasa Fund), as well as the products they offer. Potential players were classified as government, institutions, regulated and unregulated lenders. Chapter 3 identified the criteria for sample selection for conducting in-depth interviews. This chapter presents a company - and client profile and a description of the products and lending methodology of each organization that was selected as participants.

The purpose of the interviews was to test the appetite for organizations to be involved in developing a niche loan targeting RDP recipients and used for the upgrading of a backyard shack. Research questions related to identifying concerns and prerequisites related to involvement in such a niche product development.

The literature review indicated that the Kuasa Fund’s loan product showed the closest resemblance to the proposed niche loan. Secondary data was used to construct a profile of the Kuyasa Fund to enable a comparison of the interview data with the secondary data of the Kuyasa Fund in the Analysis presented in Chapter 5.

### 4.2 PROFILE OF POTENTIAL PLAYERS AND FINDINGS OF INTERVIEWS

Respondent and Background (F= Financial S= Social P= Policy)	Organization type	Primary Objective	Product	Client profile match
4.2.1: F	Commercial	Commercial, Socially Responsible Investment	Create financial vehicles	Indirectly. Partners with MFI’s to finance low-income housing.
4.2.2: S	NGO	Social	SMME funding for businesses creating employment	Yes, in terms of income level; however funding is limited to entrepreneurs.

4.2.3: F	Commercial lender	Commercial	Mortgage loans to property owners to enable them to develop low-middle income rentals	No, but experience in risky mortgage lending.
4.2.4: F	Social Housing Institute	Social	Develop rental housing	Yes

*Table 4.2.1: Contextualising the potential players*

#### **4.2.1 Development Impact Funds: Old Mutual**

The Development Impact Fund focuses on socially responsible investments (SRIs) that provide investors with commercial returns while delivering positive social and developmental impacts on scale. The fund invests in assets/areas where gaps or backlogs in social infrastructure have not been adequately addressed, with a primary focus on developing affordable housing and providing access to quality education ([http://www.oldmutual.co.za/corporate/asset-management/om-investment-group-\(sa\)/boutiques-and-units/alternative-investments/development-impact-funds.aspx](http://www.oldmutual.co.za/corporate/asset-management/om-investment-group-(sa)/boutiques-and-units/alternative-investments/development-impact-funds.aspx), accessed on 20-10-2013).

The Development Impact Fund co-fund microfinance organizations by setting up new financial vehicles and structuring R300-R700 million deals and finding operators (such as existing microfinance organization) to partner with.

The organization was included in the sample, based on the organization's experience in setting up financial vehicles for the development of affordable housing.

##### **4.2.1 a) Unique contributions from the interview**

The respondent indicated the need to partner with Social Housing Institutions already receiving government subsidies and with a proven record of rent collection. The respondents also noted that a government subsidy does not improve the loan to asset value ratio, because you cannot access asset in the event of loan default. The respondent highlighted concerns related to using an RDP house as collateral and the reputational and potential legal risks associated with seizing a RDP house in event of loan default.

The respondent have not previously come across such a loan as the niche loan proposed by the research. The respondent mentioned the issue of scale, as they usually get involve in structuring R300-R700 million deals.

#### **4.2.2 Masisizane Fund**

The Masisizane Fund is an initiative of Old Mutual established in 2007, in consultation with the National Treasury of South Africa. The fund was set up as a non-profit development funding company to provide loan financing and support to Small, Medium and Micro Enterprise (SMME's). The mandate of the Masisizane Fund is to contribute to employment creation, reduction of inequality, economic growth and attraction of investment to development and promotion of entrepreneurship (<http://www.oldmutual.co.za/about-us/transformation/masisizane.aspx> accessed on 13-10-2013).

The fund partners with others MFI's offer loans with a maximum repayment term of 5 years. Minimum direct loan amounts will be R150 000 and maximum R10 million. Financing must be for legal businesses and activities and excludes finance for residential real estate.

The organization was included in the sample, based on the organization's loan provision to individuals of a similar income level and to determine whether an organization with a social agenda would consider landlords as small-scale entrepreneurs.

#### **4.2.2 a) Unique contributions from the interview**

The respondent highlighted the need to consider whether the proposed niche loan will benefit the community or simply the individual.

#### **4.2.3 A mortgage lender that did not want to be named**

The organization was included in the sample, based on the organization's experience in mortgage-backed loans repaid with rental income, which is similar to the proposed niche loan that would be mortgaged by an RDP house and repaid with rental income received.

#### **4.2.4 a) Unique contributions from the interview**

After conducting the interview, the transcript was sent to the respondent, who indicated that they were not comfortable with the inclusion of a number of statements. In order to comply with the ethical requirements of this research, the unique contributions from the interview is excluded from this section, as is any detailed discussions that took place. The interview was important in terms of confirming themes identified by other respondents and general statements are therefore included in Table 5.3.

#### **4.2.5 IMIZI HOUSING ORGANISATION**

Imizi is a not-for-profit housing organization that leverages government subsidies for the development and management of affordable housing for rent (<http://www.imizi.co.za>, accessed 28-10-2013). Clients earn between R2500-R7500 per month who have not previously received an RDP house.

The organization was included in the sample, based on the organization's similar client profile to that of the proposed loan's targeted clientele. Respondent 1 also indicated that commercial players would need to partner with housing institutions and suggested including such an organization in the sample.

#### **4.2.5 a) Unique contributions from the interview**

The respondent stated that involvement in the development of a niche loan could be good business development for their organization in terms of creating a culture of rent-paying tenants. The respondent indicated that they would require the homes from which they are collecting rent to be in close proximity. 150- 200 households would need to be involved for them to be enticed to undertake a pilot project. The respondent also highlighted the need for education of recipients to invest any excess income into a value-increasing asset.

### **4.3 KUYASA FUND**

As stated in the literature review, the Kuyasa Fund is at the forefront of HMF in South African and is one of the few microlenders that has managed to successfully link subsidy and microfinance (Kuyasa Fund Annual Report 2006/7). The organization's product and client profile is most similar to the niche loan product proposed by this study. Whilst an interview was not secured with the Kuyasa Fund, numerous authors have published research on the fund, with secondary data freely available.

The Kuyasa Fund is a non-profit organisation that enables access to housing finance for low-income individuals (Gardner, 2008). The objective of the Fund is to lend to clients at the same time of the subsidy disbursement so as to increase the house size at the point of delivery (Kuyasa Fund Annual Report 2006/7). The Fund targets predominantly unbanked, low-income urban households wanting to improve their housing circumstances (Gardner, 2008).

#### **4.3.1 Unique attributes**

This section highlights the unique attributes of the Kuyasa Fund that may not be easily duplicated by other organizations wishing to develop a similar product.

##### **4.3.1 a) Operating at a micro scale**

The success of the fund's methodology relates to extending credit on a sustainable basis into mostly unbanked communities (Gardner, 2008). Savings are held as collateral during the term of the loan (Gardner, 2008). The loans are

relatively small. Whilst the size of such a loans (as measured in 2008) rarely exceeded R15 000 and whilst the term of the loan averages somewhere between 7-60 months, both these components are unregulated (Gardner, 2008). The company is not for profit and has a very specific focus. This narrow focus is unlikely to be duplicated in commercially orientated organizations.

#### **4.3.1.b) A wide range of investors backing the Kuyasa Fund**

The Kuyasa Fund's investors include local funds, pensions and government development funding institutions. These investors provide grants and debt for onward lending or guarantees and equity (Kihato, 2013). The fund is highly subsidized and benefits from donor funding and government capital. This makes it viable to issue smaller loans than conventional players in the HMF field.

# CHAPTER 5

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## 5. ANALYSIS

### 5.1 INTRODUCTION

This chapter presents an analysis of the primary and secondary data that was collected. Due to the diverse nature of the respondents, the analysis includes contextualizing the responses from recipients. The analysis identifies reoccurring themes relating to responses to research questions asking respondents to identify concerns related to - and prerequisites for getting involved in a niche loan product development. Lastly, the credibility of the themes identified are tested by making comparisons with the Kuyasa Fund (offering a loan that closely resembles the proposed niche loan) and asking field experts to comment on the validity of themes related to perceptions of respondents.

### 5.2 CONTEXTUALIZING RESPONSES

#### 5.2.1 Academic and professional background

The research design was such that respondent came from varied academic and professional backgrounds. The concerns highlighted in the interviews were strongly correlated to the area of the respondent's expertise. For example, the Masisizane Fund interviewee stated upfront that her background was non-financial and similarly, her concerns were more focused on social justice issues, whereas respondents from the Impact investment fund highlighted more financially related concerns. The responses therefore need to be contextualized in terms of the respondents' knowledge of the field and their abilities to consider concerns relating to the product. This context is provided in table 4.2.1.

#### 5.2.2 Degree of empathy

The statements from respondents were coloured by their individual perception of victimhood and attitude towards RDP recipients. Many respondents who highlighted social justice concerns had empathy for backyard shack dwellers and considered RDP recipients as individuals "who had already received help from the government".

### 5.3 THEMES IDENTIFIED

The following themes were identified in analyzing the responses to research questions around prerequisites for getting involved in the development of a niche

loan. The themes reflect ideas that were expressed by a number of the participants, regardless of their academic background or organizational affiliation.

Overarching theme	Theme	R1: Development Impact Fund  SRI Fund  (Finance background)	R2: Masisizane Fund  Social Investor  (Social background)	R3: A mortgage lender that did not wish to be named  Mortgage lending for rental housing projects  (Financial and social background)	R4: Imizi Social Housing Institution  (Finance background)
Commercial	Risk associated with using an RDP house as collateral for a loan	Little recourse in event of default. Legislation against taking RDP house. Bad press for any company involved.		If RDP recipient defaults on loan, you cannot put someone else in his RDP house. There is a lack of risk spread.	
	Economies of Scale	Generally only involved in larger deals (R300-700 million).		Could pilot the idea of a niche loan as a cluster concept, if everyone in a community is willing to participate.	To make rental collection viable, the households would need to be located in close proximity.
Collaborations	Finding the right partner	Commercial players would need to partner with Social Housing Institutions with track record of rent collection.			
Perceptions	Generally averse of risk.	No precedent for this type of loan.	Cannot get involved in anything that is illegal. [Illegality refers to the funding of the formalisation of an existing illegal structure.]		
	Social Justice		Concerns around assisting individual over community	Why assist RDP recipient and not backyard tenant? What about a "rent-to-buy" scheme to transfer ownership of rental units to rent-paying tenant?	
Education	Need for education			Financial education is required. One is more likely to have a successful pilot in the Flisp tier, where there is a greater understanding of finance.	Education around investing in appreciating assets is required.
Policy	Incremental solutions			Rent-to-buy models which does not transfer ownership immediately, but which is preceded by a period of rental, could be explored.	Staying in backyard shack could become a prerequisite for qualifying for CRU's.

	Concerns identified in relation to research question 1.
	Prerequisites for involvement in relation to research question 2.

Table 5.3: Interviews organized according to themes ([ ] Indicates author's note)

### **5.3.1 Commercial themes**

#### **5.3.1 a) Risk associated with RDP house as collateral**

Respondents (both commercially and socially orientated) had concerns with considering an RDP house as a security for a mortgage loan. Financiers are more accustomed to scenarios where the asset is either in their ownership (eg a rent-to-buy development) or under their control (eg a body corporate). In the case of RDP homes, it was anticipated that there would be enormous political risk in evicting someone from the RDP house for non-performance on a mortgage-backed loan.

#### **5.3.1 b) Economies of scale are required to ensure financial viability**

Banks often excludes low-income clients, because the administrative costs do not justify the profit being made. By virtue of the low rentals that would be received and the relatively small loans granted, a similar problem would exist for the granting of the niche loan proposed by this research. The effort and administration costs involved in setting up the structures required for such a project would make it difficult to cover costs. SHI would require the homes from which they are collecting rent to be in close proximity. Respondent 5 indicated that 150- 200 households would need to be involved for them to be enticed to undertake a pilot project. Respondent 4 also mentioned the concept of a cluster. Generally speaking, it would be easier to collect rent in a rental model.

Respondent 2 structured financial vehicles for R300-R700 million deals. One of the examples cited by respondent 2 related to a greenfield site that included a formalized rental unit in the initial package (Malibongwe Ridge). This could be delivered due to the scale of the development, which allowed for cross-subsidization. The niche loan for upgrading a backyard shack would need to be piloted in a community where the majority of households are willing participants in order to achieve a scale that is financially viable.

### **5.3.2 Collaboration themes**

#### **5.3.2 a) Finding the right partner**

The more commercially orientated respondents highlighted the need to partner with an organization that is already subsidized and that have a proven rent collection history. Social Housing Associations were specifically identified as partners. Other respondents also highlighted the need to partner with a community in order to obtain economies of scale.

### **5.3.3 Perceptions**

#### **5.3.3 a) General Risk Averseness**

The more commercially orientated players exhibited risk averseness and often cited that “such a loan has never been done”. When asked if Government could mitigate the risk in any manner, commercial players indicated that if the asset to loan ratio is not acceptable, a subsidy would not improve the underlying risk.

#### **5.3.3 b) Social justice**

Assuming the ownership of the RDP house still vested with the original recipient, there were social justice concerns with using the RDP house as collateral. In the event of default, one would create a homelessness problem if a financier reclaims a house, which also defeats the initial purpose of the RDP house as a means to address homelessness. If the house had been sold on to a new owner on an open market, these concerns were not relevant. Whilst such sales do take place, they are often not reflected on title deeds.

Another social justice theme was prioritizing the community over the individual. Respondents with a more social background and from organizations with a social mandate were interested in scenarios where an entire community would be involved. Many of the social organizations that have funding available have specific criteria for spending, which specifically exclude funding that will benefit the individual.

### **5.3.4 Education themes**

Respondents with experience relating to working with housing subsidy beneficiaries highlighted the need for financial education of the intended recipient of the loan and the need for education relating to investing in appreciating assets. These respondents highlighted that individuals do not actively invest in their homes and assume that its value will increase over time. Respondents also mentioned that recipients in the FLISP market (who earns more than the recipients of RDP housing) have a better appreciation of the benefits of investing in properties.

### **5.3.5 Policy themes**

Very innovative ideas were presented by some of the respondents, which did not relate to the research questions and which resulted in discussions that were not prompted by the author. One such idea was to incentivize individuals to stay in

backyard shacks for a number of years as a way of qualifying for a CRU unit. Respondents indicated that social rental models would be easier to manage and facilitated easier rent collect.

Respondents expressed interest around applying a “rent-to-buy” loan concept to the Flisp market to enable the construction of rental units and mentioned an example of a recent development where the subsidized housing unit was designed in such a way that a section of the unit could be rented out. The author recognizes the virtues of such initiatives; however it does not address the concerns related to existing backyard shacks.

It remains unlikely for such a “rent-to-buy” model to be duplicated and introduced retrospectively in RDP housing projects, due to ownership challenges. The portion of the property on which the rental unit is located would need to subdivide off the main plot. As this is generally to the rear of the property, servitude rights of way would need to be registered to ensure the rear portion can be accessed. It is highly unlikely that the local authority would allow the creation of such small land parcels. Also, given the complexities involved such as registering servitudes and issuing new title deeds, it is unlikely that the positive impact of such an intervention would justify the administration cost.

## **5.4 CREDIBILITY OF THEMES IDENTIFIED**

### **5.4.1 Opposing Views**

None of the respondents expressed views that were in direct contradiction to the views of other respondents. Whilst this does not necessarily imply that the data is reliable, the absence of opposing views means that further investigation into statements of contradiction was not required. Due to the small size of the sample of respondents, it was recognized that the risk of respondent bias was high.

### **5.4.2 Validation of themes by means of comparison with secondary data**

The above-mentioned themes represent the concerns and broad prerequisites for respondents to get involved in developing a niche loan for the upgrading of backyard shacks. In the literature review, the Kuyasa fund’s savings-backed loan was identified as the only product that closely resembles the niche loan proposed by the research in terms of application and targeted customer. Given these similarities, one should ask whether the Kuyasa fund overcame the concerns and prerequisites identified by the respondents or whether the fund is not affected by similar concerns.

The Kuyasa Fund avoids many of the commercial concerns identified, by virtue of the organisation’s non-profit nature. Furthermore, the concerns around risk

associated with using the RDP house as a guarantee is avoided, as the Kuyasa loans are savings-backed. The savings-backed nature of the loans implies that loans are smaller than loans that could be mortgage. Whilst this is key to the Kuyasa Fund's ability to have a sustainable loan book, the nature of loans is unlikely to be commercially profitable.

#### **5.4.3 Validation of themes by means of personal communication with government officials**

The respondents highlighted the risks associated with using an RDP house as collateral for a loan. To establish whether this risk was real or perceived, the author used a convenience sample of anonymous government officials with experience in government housing to comment on the reasonability of the theme. The officials confirmed the risks associated with Housing, due to political and emotive factors.

### **5.5 CONCLUSION**

This chapter provided an analysis of primary data collected in the interview. Respondents were questioned on concerns related to - and prerequisites for getting involved in the development of such a niche product. Responses to both research questions were analyzed and prevalent commercial -, perception -, education - and policy related themes were identified as overarching themes.

Concerns related to

- commercial concerns related to risk in relation to using RDP houses as collateral, and achieving economies of scale;
- perceived concerns related to social justice issues and general risk averseness.

Prerequisites for involvement related to

- finding the right partner;
- providing personal financial education to potential customers and promoting investment in assets that accrue value over time.

## CHAPTER 6

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### 6. CONCLUSION AND DISCUSSION

#### 6.1 INTRODUCTION

The objective of the research was to test the appetite of potential players in the HMF field for getting involved in developing a niche loan targeted at the upgrading of backyard shacks. The concerns and prerequisites of such players to get involved were identified as a means to test their appetite for involvement. This chapter presents the findings of the research, which are discussed in context of alignment with the research assumptions and literature review. Lastly, suggestions for further research are proposed.

#### 6.2 RESPONSE TO RESEARCH QUESTIONS

The research questions related to the identification of concerns and prerequisites for potential players to get involved in developing a niche loan product targeting RDP recipients and used for the upgrading of backyard shacks.

The two predominant themes from the concerns recipients identified related to risk associated to using a RDP house as collateral for a loan and concerns around social justice issues. Other themes from the concerns recipients identified include general risk averseness, a requirement for economies of scale.

Prerequisites for involvement related to collaborations between commercial players and social housing institutions and the need to partner with communities to test pilot schemes. Another precondition related to the need for a financial education campaign targeting the potential niche loan customers. The latter prerequisite mentioned above was identified as an action that the government can take in terms of promoting investment in assets that will increase value and not immediately devalue (such as cars, TV's ect, which loses value after first use and have low resale value).

#### 6.3 DISCUSSION

##### 6.3.1 Findings that align with the research assumptions, expected results and the literature review

In general, there was significant correlation between the respondents' answers and the findings of the literature review. This could be explained by two factors. Firstly, there are few players in this sector and most companies are familiar with

their competitors' business models. Secondly, most of the respondents were academically inclined and highly educated individuals with multiple degrees and with a keen awareness of published papers on the topic and new developments in the industry. This was evident from the fact that many of the recipients cited the recently developed Malibongwe Ridge as an example of a low-income housing development that caters for low-income rental unit in the preliminary design.

### **6.3.1 a) Assumptions related to Limited Commercial Interest**

The interviews confirmed the research assumptions that interest from commercially orientated players would be limited. The low demand from commercial players was one of the expected results identified in Chapter 3. Interestingly, the social housing organization (whose primary business is Community Rental Units) indicated that they could consider their involvement in developing such a niche loan as "business development". This is due to the fact that there are entitlement perceptions around any asset that is government owned and tenants in Community Rental Units (CRU's) are often resistant to paying rent. The backyard shack tenants could be excellent candidates for CRU's, as they are used to paying rent. Whilst the commercial merits of providing a niche loan are limited, the scope it offers for businesses development (such as expanding the customer base and accessing previously untapped markets) should be considered from an organization's broader business development aspirations.

### **6.3.1 b) Social Justice Concerns**

Respondents expressed concerns over helping individuals as opposed to helping the community. This concern was also evident in the literature review, albeit that the focus in the literature review was more related to concerns around the displacement of the current tenant in the backyard shack (Watson, 2009). The desire to help the community over the individual shifted the focus of many interviews. Whilst the initial objective of the niche loan was to generate an income stream for RDP recipients, respondents were interested in mechanisms that would allow backyard tenants to become owners of their units through a rent-to-buy scheme. Such a scheme would require a different ownership structure and would be difficult to establish retrospectively in government-sponsored housing developments; however it is being tested in greenfield developments such as the Malibongwe Ridge development in Gauteng. This development includes a residential unit in the initial design in order to development rental units at scale.

Although social justice concerns were specifically highlighted in Chapter 2's Literature Review, it was surprising to witness the extent to which social justice

concerns flavoured the interviews; regardless of whether the respondent worked for a socially or commercially orientated organization.

### **6.3.1 c) Prerequisites related to Individual Financial Education**

The respondents indicated the need for education for recipients of RDP houses as a prerequisite for involvement in developing a niche loan. Such personal finance education would relate to maximizing the value of the RDP house and how to use personal savings to invest in assets that will accrue value over time as a prerequisite for involvement. This is in line with the literature review that refers to the need for individuals to change their perceptions of themselves as being passive recipients who are dependent on the state to becoming actively involved in meeting their own housing needs and mobilizing resources as end-user contributions (FFC, 2013). Gardner (2008) states that research has shown that many individuals are unaware of formal financial markets or do not understand the cost of consumer credit. Households accessing credit are using very little credit for long-term assets and most is being used as consumer credit (Gardner, 2008).

Gardner (2008) suggests that consideration be given to the development of national campaigns driven by key industry players (such as Department of Housing); showcasing the benefits of procuring HMF to the housing microcredit target market. Given the political legacy of the ruling party promising houses for all, it is unlikely that the Government will ever become involved in an education campaign denouncing dependence on government-sponsored housing. However, the government could drive education campaigns around awareness of the downfalls of investing in depreciating assets and the benefits of investing in appreciating assets.

### **6.3.1 d) Government actions required**

The literature review calls for the government to invest in resources or scenarios that will stimulate additional funding from the private sector (FFC, 2013). It is clear that the commercially orientated players in the private sector is risk averse and would need justification for investing their customers' money in a high risk investment. A respondent pointed out that the subsidies offered by government would provide little relief for the commercial player, as it would not improve the loan to asset ratio. Potential commercially orientated players would rather partner with organizations that are already accessing subsidies. This is in line with Gardner's (2008) prediction that large banks will forge relationships with niche housing microlenders to build capacity in the sector.

Whilst the government cannot entice the commercial players directly, they can incentivize organizations already accessing government subsidies to pursue collaboration with commercial players.

One of the concerns identified by respondents related to the risk associated with using an RDP house as collateral for a loan. Restrictive title deed conditions are imposed on RDP houses, with most RDP houses subject to an eight-year prohibition on selling or letting the land and permitting only one dwelling per property (<http://www.ngopulse.org/category/tags/rdp-houses> accessed on 01-11-2013). These patronising laws deny RDP recipients the right to own and deal freely with their land (<http://www.ngopulse.org/category/tags/rdp-houses> accessed on 01-11-2013). A critical government action is therefore to change this situation. Such a decision will require political backing at the highest level.

### **6.3.2 Findings contrary to the literature**

#### **6.3.2 a) Perceptions of Victimhood**

One of the serendipitous findings was that respondents' perception of victimhood had an impact on their responses. Many respondents had a greater degree of empathy with backyard dwellers and were interested in developing products for backyard tenants to buy their units. This steered many interviews into a discussion around "rent-to-buy" models, despite this discussion not directly relating to the research questions.

From the literature review, it is evident that in many instances, the backyard dwellers had higher incomes than the landlord and was not victims of an exploitive relationship between landlord and tenant; as is often assumed (Govender et al, 2011).

The author considers the degree of victimhood in relation to an individual's ability to access opportunities to improve their circumstances. Backyard dwellers are considered to be more mobile with a greater disposable income; whereas RDP recipients had little recourse in terms of pursuing income-generating opportunities in other geographical areas, once they received their house. As they are required to stay in the house for 8 years before being able to sell the house, the asset-value of the RDP house cannot be accessed immediately.

Even if the RDP recipient is considered as not being entitled to any additional government assistance, the government still has an incentive to assist RDP recipients maximize the potential of the subsidized house and plot in order to achieve government objectives such as densification, increased welfare and rates contributions as well as improved maintenance of RDP houses.

The different perceptions of victimhood by the interviewer and respondents may have introduced certain biases in the exploratory research. Suggestions to improve the trustworthiness of findings include conducting interviews after an

informative workshop attended by all respondents. This is further elaborated on in Section 6.4 (Suggestions for further research).

### **6.3.2 b) Critique of Government Policies and Actions**

Chapter 2's literature review included a critique of government Housing Policies and subsidies. One of the expected results in Chapter 2 was that non-government organizations would be critical of Government policies and actions. Contrary to this expectation, recipients had either neutral or positive views of government policies and actions and cited positive experiences with subsidy disbursement. Whilst political risk was highlighted as a concern and whilst one recipient referred to working with government as "an added complexity", there was no specific or direct critique of current policies.

This lack of critique could be explained by two factors. Firstly, organizations such as Social Housing Institutions would not blatantly criticize the government if their business models were dependent on receiving government subsidies. Secondly, government policies and actions have continuously changed and players in the housing sector may accept the continuous changes as a political *fate accompli* and simply navigate their way through or around such policies and actions, without interrogating the content of the policies.

In order to realize meaningful engagement with potential players that could provide a niche loan for the upgrading of backyard shacks, an honest discussion around the success of existing government interventions is required. The need for engagement with government is discussed as a future research suggestion in Section 6.4.1.b).

## **6.4 RECOMMENDATIONS**

### **6.4.1 Recommendations for further research**

The following recommendations are made to improve the credibility of future research on the topic of upgrading backyard shacks and to highlight areas of potential future research required.

#### **6.4.1 a) Conducting interviews after an informative workshop**

One of the challenges of conducting research on a multidisciplinary topic is that there are few respondents who have a broad understanding of all aspects of the topic. Respondents in this study were from different academic and working backgrounds and either had a strong government policy background, social background or a strong financial background. An attempt was made to explain the broader context of the problem and to sensitize those with a financial

background to the policy side and vice versa by sending background information prior to the interview and explanation at the start of the interview. Whilst this assisted in preparing the respondents, the complexities cannot be sufficiently unpacked in such a short period of time.

It would be useful to conduct interviews after a daylong workshop where professionals from these three different backgrounds present insight from their perspective. If interviews were conducted after such a workshop, all respondents would be equally aware of the challenges outside their conventional professional realm. This will also assist in addressing concerns around the trustworthiness of in-depth interviews due to the influence of respondents' bias.

#### **6.4.1 b) Increasing the sample size**

In order to expand this research, critical comment is required on the current role the government plays in upgrading backyard shacks and the future role it would need to play to encourage the private sector to provide the type of niche loan proposed by this research. It is suggested to increase the sample size beyond potential players in the HMF fields and to include organizations that are not dependent on government grants or subsidies, but that can critically comment on the government's role. Such organizations could include independent think tanks that have published extensively on the topic of housing provision in South Africa.

It is also necessary to obtain commentary from government officials working in the housing departments on these critiques and the viability of suggestions made regarding a revised role for the government. Due to the political nature of such research, it is suggested that an independent research body undertake the research. High-ranking officials within government should support such a research initiative, so that respondents can answer research questions without fearing the political consequences of their responses.

#### **6.4.1 c) Testing rental demand and price flexibility**

In Section 1.2.7, it was assumed that sufficient demand exists for a niche HMF product specifically designed for financing the formalization of backyard shacks in RDP housing projects in urban South Africa. It was also assumed that tenants' demand for low-income rental units will remain, even if the rental increases. These assumptions were made to test the appetite of potential players in the HMF field to produce a niche loan product. For the purpose of this research, the parameters of such a niche loan product were considered to be flexible.

Further research is required to determine how the demand for low-income rental is affected by rental increase. This will have a significant impact on the parameters of the loan. If the loan is issued, based on the assumption that the loan will be repaid via rental income, it is important to ensure that the rental of the

formalized backyard unit is not too high to attract rent-paying tenants. MFI's would also require certain parameters in terms of

- loan eligibility (projected income vs. current income)
- loan amounts (group vs. individual loan)
- loan sequencing (stand-alone product vs. complimentary with other microfinance products)
- loan maturity

#### **6.4.2 Policy Recommendations**

The literature review found that backyard shacks deserves much greater attention from policy makers (<http://www.hsrc.ac.za/en/review/hsrc-review-may-2013/census-2011-reveals-boom-in-backyard-shacks>, accessed on 10-12-2013). Lemanski (2009) states that policy-makers perceive the causality between augmented informality and the housing policy as an agency problem related to homeowners' ignorance and ingratitude, rather than being a structural by-product of the government's housing policy. Government policy therefor needs to recognize the need of the poor to extract the maximum value from their biggest asset, namely their RDP house.

##### **6.4.2 a) Enabling the use of RDP houses as collateral for loans**

The interviews have highlighted the risk associated with using RDP houses as collateral and the difficulty of extracting value out of the RDP house as an asset. This highlights the importance of giving due consideration to rules that might "sterilize" the intrinsic value of the asset (such as conditions preventing the sale of property). Even in cases where the required 8 years have lapsed and where RDP house can technically be sold on, banks are hesitant to consider RDP homes as collateral. The unwillingness of banks to seize a subsidized house is understandable; given the potential media backlash that such an action could unleash. It also seems counter-intuitive to take a subsidized house from someone who will be homeless without it- thereby eradicating the very objective of the government to house people.

Since 1994, about three million RDP houses have been allocated to black South Africans. Land audits estimate that official beneficiaries occupy less than half of all RDP - and township houses due to unlawful sales (<http://www.ngopulse.org/category/tags/rdp-houses> accessed on 01-11-2013).

A legal exemption could be made that once the RDP house has changed ownership, it can be used as collateral for a loan. It essentially loses its "subsidized" status the moment it is purchased by a new owner. It is only fair that such a purchase should deem the house to be a normal asset.

## 6.5. CONCLUDING THOUGHTS

This study gauged the appetite of potential players in the HMF sector to develop a niche loan targeting RDP recipients and used for backyard shack upgrading by means of conducting in-depth interviews. These interviews identified concerns and prerequisites of potential players for involvement in such product development.

As predicted in the research assumptions, the appetite from commercial players was limited; however significant interest was expressed for applying a similar loan concept to the Flisp market to enable the construction of rental units. The only successful development of a product similar to the niche loan proposed by the research is the Kuyasa Loan. Chapter 5's Analysis found that the Kuyasa Fund managed to avoid many of the concerns identified by recipients by virtue of their loan being savings-backed and operating at a scale much smaller than what would be viable for commercial players.

As one moves lower down the income ladder, the impetus for providing loan products generally become more socially than commercially driven. It was therefore striking that regardless of whether respondents worked for organizations with social or commercial objectives, all respondents had strong views on the social justice implications of a niche loans targeting RDP recipients and not the backyard tenants. Perceived and real issues around social justice implications of such a niche loan were identified as a concern. Given the political nature of low-income housing, this concern is especially significant for commercially orientated players who have well-established brands and reputations that they would not want to tarnish.

Much of the resistance to engaging with backyard shacks is due to the stigma's associated to these housing forms- be it their illegal status or the quality of life they offer tenants. The tragic reality is that a rented backyard shack remains a preferred alternative to squatting free of charge in informal settlements for many individuals. Whilst the social concerns relating to backyard shack interventions are justified, it should not delay intervention indefinitely. In order to address the social concerns of players in the HMF field, the government needs to provide high-level political endorsement of backyard shacks as an incremental solution to the pressing housing needs.

The provision of a niche loan was premised on using an RDP house as collateral for such as loan. From the interviews conducted, it is clear that there is a lack of recognition of the potential value of RDP houses as assets from financiers, as is evident from a respondent referring to RDP houses as "give-away products". The literature indicates that this attitude is also prevalent amongst recipients, who are not actively investing in their homes. Blockages to the realization of the asset

value of RDP houses need to be removed, such as current legislation preventing the on-sale of RDP houses.

Prerequisites for involvement related to the establishments of new partnerships between commercial players, social housing institutions and communities. Furthermore, education around personal financial investment decisions was identified as a prerequisite for involvement. The promotion of savings is required to ensure that recipients are actively participating in improving their long-term welfare.

The government is well placed to champion both changes to legislation preventing the on-sale of RDP houses and education around personal financial investment. This will go a long way to decrease the risks associated with using RDP houses as collateral and to address the concerns and prerequisites identified by respondents.

A wide range of further research suggestions were made, as it is recognized that the provision of loans for the formalization of backyard shacks will be challenging and will requiring a wide range of role players to solve complex inter-disciplinary problems. Key to unlocking the potential of backyard shack formalization will be the coordination of multiple players' actions and collaborations, including the target client's investment behavior and the government's policy.

This study has shed light on the concerns and prerequisites of potential players in HMF to develop niche loans targeting backyard shack formalization. Whilst the development of such a product could realize government objectives relating to backyard shack formalization, many of the concerns and prerequisites of potential players can be partially addressed by the government. It is hoped that this study has contributed to starting a conversation on how potential players in the HMF sector can form new collaborations to leverage the government to provide them with the required support and incentive to address a critical issue in the urban landscape of South Africa.

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### **Online resources**

[http://www.oldmutual.co.za/corporate/asset-management/om-investment-group-\(sa\)/boutiques-and-units/alternative-investments/development-impact-funds.aspx](http://www.oldmutual.co.za/corporate/asset-management/om-investment-group-(sa)/boutiques-and-units/alternative-investments/development-impact-funds.aspx), accessed on 20-10-2013.

[http://www.ehow.com/facts\\_6778649\\_validity-reliability-focus-groups.html#ixzz2GRWc57ZK](http://www.ehow.com/facts_6778649_validity-reliability-focus-groups.html#ixzz2GRWc57ZK), accessed on 29-12-2012.

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### **Forthcoming literature**

Centre for affordable housing finance in Africa (forthcoming) *State of Housing Microfinance in Africa*.