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COST BENEFIT ANALYSIS: SOCIAL RENTAL HOUSING

Think Piece 2: Housing as a Public/Social Asset

This is one of four Think Pieces prepared by the Social Housing Foundation (SHF) based on the findings of a Cost Benefit Analysis (CBA)[1] of Social Rental Housing (SRH).

Key Policy Issues from the Cost-Benefit Analysis

- The CBA research indicates that from an economic perspective RDP housing is not a strong public / social asset. This is a consequence of:
  - Lower quality specifications and poor construction quality as a consequence of the limited funding available for top-structures
  - The high-level of ongoing investment required by the government in order to maintain these assets in particular the current rectification programme
  - The low levels of household affordability evidenced in the limited household contribution to maintenance
- The often peripheral location, limited property market and legislative restrictions further limit the ability of RDP units to be effective financial assets.
- However, RDP does perform an important function as an asset for home-based survivalist business, which is of importance given the significant poverty and unemployment of many beneficiaries.
- SRH, while more expensive to build and operate, provides long-term social assets to society because of its better building quality, effective maintenance provision and ongoing institutional management.
- Key lessons in respect of SRH – such as effective institutional management and proper provision for maintenance – should be considered in the optimisation of RDP-type delivery models.

Each paper highlights a specific theme extracted from the CBA which assessed the economic and social costs and benefits to South African society of SRH compared to RDP housing over a 40-year future timeframe. Applying CBA methodology to housing research is new and the findings have wide ranging consequences for future policy makers across all spheres of government. It is anticipated that the content of these papers will contribute meaningfully to public debate and policy making in relation to housing and urban development in the future.

This Think Piece discusses the issue of housing - specifically social rental housing - as a public asset. This is set against the current debate and concerns as to whether RDP has and can fulfill its function of providing an asset to poor households. Ultimately the CBA reflects on this debate from the view of South African society and highlights the concerns and trade-offs that face policy makers.

1. Social Housing Foundation (2009): Cost Benefit Analysis, RDP & SRH

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Background to this Paper

The provision of subsidised housing has been one of the cornerstones of the South African government's broad social welfare programme since 1994. Social Rental Housing (SRH) and Reconstruction and Development Programme (RDP) housing (also known as BNG housing) are two housing types, amongst others, that exist within government's current housing programme.

Social Rental Housing is defined as a form of medium-density rental housing which is typically well located in terms of its access to urban areas. It is usually multiple storey housing due to the fact that it is built on prime land where land prices are high. The intended effect of SRH in South Africa is to:

- Contribute to urban restructuring;
- Address structural economic, social and spatial dysfunctionalities; and
- Improve and contribute to the overall functioning of the housing sector.

By contrast, RDP housing is mainly low-density, low-cost housing typically located on the periphery of towns which is owned by households. It usually consists of single storey housing constructed on separate plots. While SRH is the main focus of this think piece, RDP housing is frequently compared since it has been the dominant form of subsidised housing in South Africa to date.

Cost Benefit Analysis

Cost Benefit Analysis (CBA) methodology is new in South Africa in the field of housing and offers innovative ways of answering housing policy questions. CBA is a powerful economic decision making tool used to assess whether a (housing) project contributes to an increase in the general welfare of society or not.

It does this by clearly identifying and quantifying in money terms the full range of costs and benefits of a housing project, over the entire life cycle of the project (40 years in the case of a housing project). The costs and benefits included are both direct ones, (such as the cost of building the house), and indirect ones, (such as the benefit of safer neighbourhoods).

The advantages of the CBA approach need to be balanced against some of its inherent limitations and restrictions. While it adds a valuable economic perspective to decision making, it does not replace the decision making itself, which should still contain other equally critical political and social considerations. Of necessity, a CBA simplifies reality and uses assumptions. While it attempts to include the most critical factors in these assumptions, assumptions are by their nature generalised.

The CBA undertaken used six existing housing projects in South Africa; three from RDP-type housing and three from SRH-type housing. It included the development of a financial and economic model; extensive primary and secondary research collected through a social survey of some 600 households; a review of local and international economic literature in relation to housing and economic effects; and engaged with a dedicated project reference group, comprised of housing and economic specialists. The study also considered who in South Africa receives the costs and benefits through a distributional analysis, and considered the specific fiscal burdens or advantages to government.

Do SRH and RDP Houses make useful Public or Social Assets?

What economic impact does affordable housing have for households, for our cities, for the government, for the economy, and for South African society at large? Do the affordable houses being delivered (both SRH and RDP) contribute to broader economic development and sustainability, and are maximum economic spin-offs being achieved?

These are important questions that need to be asked about affordable housing and its role as a public or social asset.

Housing assets perform differently for different stakeholders, at an individual and public level. A lot of emphasis is given to asset creation through home ownership in publicly-supported housing programmes. The CBA contributed some fresh insights from a financial-economic perspective to the debate about housing as an asset for individuals and society.

How Housing has been Defined as an Asset

Housing is generally considered a valuable asset, both for homeowners and society. For households and society, houses can perform as a social, economic and financial asset (Rust, 2008). As a social asset the house enhances identity and security, helps to build social networks and allows a household to access a range of social services and amenities. As an economic asset, housing can help a household generate an income through home-based enterprises or by providing rental accommodation. In theory, a house can also be used as collateral for finance, or as a tradeable asset and a foothold into the property market.

RDP Housing as an Asset

The focus of the government's housing programme in South Africa since 1994 has been on providing a capital housing subsidy to the poorest of the poor, which provides a household with ownership of a serviced plot and a starter home. Over two million of these houses have been provided so far. Although this impressive number of houses has been delivered, there are questions about how well they have, in fact, performed as assets.

For privately-owned RDP housing, the argument is that home ownership builds the asset wealth of poor households. This is often supported by reference to De Soto's (and others) theory that the poor remain poor because they lack assets that can be used as collateral to access finance, which can then be used for economic purposes. So providing the poor with a home that they own gives them an asset they can use to leverage additional resources.

However, for the majority of RDP home owners this does not seem to have been the case. Although many have moved from informal settlements into RDP housing they formally own, many remain trapped in conditions of social exclusion and economic poverty. RDP housing is also a *supply side* intervention. Households cannot make choices about what support they need, but rather receive a designated house in a specified location. The consequence is that households are not in a position to choose an appropriate housing response given their particular circumstances and economic requirements.

Unfortunately, little beyond anecdotal local cases is known about the performance of RDP stock and whether beneficiaries are selling their homes (and for what price). However, we know that for housing to function as a financial asset a number of conditions need to be present. The foremost condition is a formal housing market in which there are willing and able active buyers and sellers. It is such a market that determines the value of houses and which underpins a banks willingness to utilise such houses as collateral for loans. The reality is that many RDP households are too poor to participate in the formal financial sector or to exercise any choice in respect of housing location. RDP projects are typically not well located and marginalised from key social amenities. This is compounded by the eight year restriction on households selling their RDP houses. Current evidence suggests that few banks are willing to collateralise RDP houses. So the ability of a RDP house to perform as a financial asset remains poor as there are very limited opportunities to transact and realise any value.

Finally current evidence suggests that from a societal perspective the RDP housing programme does not consistently deliver quality units that could be considered as long-term assets. In this regard the National Rectification Programme (estimated to cost about R2 billion) and the limited economic life of many RDP houses can be cited. In addition –as confirmed by the CBA findings – RDP housing is creating a significant fiscal burden for municipalities as they are required to absorb the ongoing infrastructure maintenance and services costs.

SRH as an Asset

SRH has a different emphasis from RDP and currently targets a smaller segment of the population within a specific income group. Generally this comprises a somewhat higher income group than RDP, given that SRH residents are required to have a regular income to be able to pay for rent. Its housing delivery is focused on urban reconstruction and improving the overall functioning of the housing sector. Unlike RDP housing, social housing rarely provides home ownership options to individuals. In SRH, the responsibility for maintenance lies with the social housing institution (SHI). The SHI undertakes this function and recoups the costs from the rental payments collected from its tenants. Default in rental payment results in tenant eviction from the building, and debt is therefore minimised, and in principle maintenance standards are maintained.

In each of these respects SRH is also focused on housing as a social and economic asset to individual households. Importantly SRH provides access to valuable economic and social opportunities in view of its proximity to key economic nodes and urban centres. Due to the rental structure SRH however does not allow for housing to be used as collateral for a loan for the resident. However, for this income group this might also be less relevant, since loans can also be obtained against a regular income.

From a societal perspective the role of SRH is to provide a stock of affordable rental units within a broader housing market. Importantly the design of the SRH programme ensures that these assets remain social and inter-generationally useful.

Findings of the CBA

The cost benefit analysis of SRH and RDP raises some pertinent issues in relation to the value of housing as a public asset. In the results the fact that individual versus public assets can't be separated is highlighted as one impacts on the other.

The financial and economic CBA

The Table below reflects a breakdown of cost categories of two RDP housing projects (Bram Fischerville and Potsdam) and two SRH projects (Roodepoort and Amalinda).

	Bram Fischerville RDP	Roodepoort SH	Potsdam RDP	Amalinda SH
Total building costs per unit	R54,083	R215,628	R113,243	R241,679
NPV[2] building maintenance costs	R13,171	R12,947	R5,199	R20,674
NPV township services maintenance	R27,178	R7,707	R27,178	R7,707
NPV utilities	R110,100	R114,993	R84,104	R132,976
NPV operating costs	R0	R72,686	R0	R80,373
Economic life	R20	R40	R20	R40
NPV rebuilding costs	R19,923	n/a	R37,391	n/a

2. Net Present Value: The difference of all the costs and benefits of a project over its lifetime, in today's money terms that can be compared. If the NPV of a project is greater than 0 (in other words its benefits add up to more than its costs), then the project is worth investing in.

The total building costs per unit of the RDP projects reflected in the table while significantly higher than the capital subsidy, are significantly lower than those in the SHR projects. This is due to the prime positioning of SRH close to urban areas and the associated high cost of land, and higher building standards and services. RDP per unit housing costs are also lower because of the impact of economic scale efficiencies due to the higher number of units typically constructed in such projects. However SRH remains a financial asset for government if well managed and maintained. RDP housing, because of poor construction and maintenance, becomes a much reduced asset for both individuals and government, as it is likely to need rebuilding after 20 years (as explained below).

Building maintenance costs appear low in general across both RDP and SRH projects reflected. The maintenance costs reflected in the table are the actual costs recorded by the housing project, (i.e. money spent on maintenance) and are not necessarily a reflection of expected costs associated with adequate maintenance standards. Potsdam RDP reflects very low maintenance costs as compared to Amalinda SRH and indicates, in all likelihood, that much of the maintenance is sub-standard.

In RDP programmes, maintenance is the responsibility of the homeowner, who technically assumes full liability for risks associated with their asset. Poor maintenance standards indicate that this role is not being adequately assumed by homeowners. It suggests that there is either a lack of understanding by homeowners of this role; or that homeowners do not perceive the value of their home as an asset worth maintaining. Given that the recipients of RDP homes are often households with very low or no sustainable income, evidence suggests that there is limited financial capability, on the part of households, to maintain homes to acceptable levels. This negatively impacts on the value of the property over time. This is further exacerbated by the original poor quality of build in RDP homes. RDP homes built under the capital subsidy scheme require developers to work tightly within the prescribed subsidy, and this often becomes the prime consideration of developers, over and above quality building standards. Poor building standards reduce the life cycle of a building. RDP homes initially anticipated having a lifespan of forty years, but are now expected to last half this period.

By contrast, SRH building quality is high and lifespan expectancy is double that of RDP housing. The responsibility for maintenance remains with the SHI.

The results of the financial CBA shows that over a period of forty years, including shorter economic life and rebuild, RDP housing is still approximately 2,5 times cheaper than SRH.

Survey results: Local economic development

A statistically significant difference was found between the two housing sectors on all questions related to home based businesses. More RDP respondents had a business in their previous dwelling than social housing respondents; more RDP respondents are currently operating a home based business than social housing respondents and more RDP respondents expressed the wish to have a home based business in future, compared to those in social housing.

This suggests that while RDP housing may not perform effectively as a financial asset, such housing does offer a segment of the population an important space to undertake survivalist business. From a policy perspective this is an important consideration, especially when it is noted that medium-density / high-density urban living requires a higher level of income and access to cash. However, as noted in Thinkpiece 1 (Location and Density) more SRH is being designed to enable people to work from home.

Distributional and fiscal results

The distributional analysis focused on examining the distribution of lifecycle financial and economic costs and benefits between the main parties related to the projects. The key parties considered included national / provincial governments, municipalities and residents. The conclusions drawn from the distributional analysis are:

- While RDP houses initially cost less than SRH financially, they create a substantial lifecycle cost to municipalities, which is not similarly carried by national / provincial governments or residents themselves.
- While SRH houses initially cost significantly more financially than RDP houses, the lifecycle costs are carried primarily by national / provincial governments, and especially residents themselves. This avoids creating the lifecycle cost to municipalities as seen in RDP housing.

Conclusion and Policy Recommendations

In this paper, we have reviewed the asset creation hypothesis against the results from the CBA research. We have defined three types of benefits that can be derived from an asset: social benefits, economic benefits and financial benefits.

The CBA research can only conclude with respect to the economic and financial benefits. For housing to perform as an asset for the resident, we have stated that several criteria should be met: unrestricted property rights, optimal allocation and affordability.

With respect to property rights, we can observe that while SRH residents do not have property rights on their houses, the rights of RDP residents are very limited due to the absence of an effective market for a number of reasons including sales restrictions, general poverty and poor location. As a consequence, financial institutions are less inclined to provide loans since their claim on the collateral is also restricted.

Optimal location in particular is necessary to arrive at the optimal value of the asset and for RDP this criterion is not met due to the combination of the supply side allocation and sales restriction. In SRH, residents have more of a possibility to influence the location in which they will live when applying for a home.

Our research shows that lack of affordability inhibits the RDP residents' ability to assume responsibility for the maintenance of the asset. Consequently, the value of the asset deteriorates and the life cycle is severely shortened. Moreover, municipalities are forced to fill the gap and contribute funds to basic maintenance on an ad hoc basis. In SRH, the SHI assumes responsibility for the maintenance of the asset and is able to collect rent to pay for it.

What does this mean in terms of policy recommendations? Clearly, the system of SRH cannot be extended to the full population currently served by RDP. This would not work without significant additional subsidisation because of the general income difference between RDP and SRH households. Still, there are several mechanisms evident in SRH which could be applied and could result in a more optimal value for the investment in housing.

There are three alternative ways of dealing with this issue:

- The first option is to leave it as it is and accept that the RDP house has a severely shortened economic lifespan.
- The second option is to move towards a structure which more closely resembles a market situation. This means introducing more freedom for RDP residents as consumers, where they can choose a house to live in and the sales restriction is lifted. The expectation is that this will create a bigger market for RDP houses. This will also make it more transparent for financial institutions as to what the market value of the house is and open up the possibility for using the house as collateral for a loan.
- The third option is to move RDP towards a structure which more closely resembles that of SRH. This means that ownership and lifecycle considerations are properly considered. There are several ways of structuring this so that RDP residents remain to a large extent in control. For instance, an owners association which has a vote in maintenance decisions but delegates the operational part, which is (partly) funded by the government. Or, alternatively, turn RDP into a rental structure this would require a fundamental revision of the current housing typology towards increased densities and the creation of management arrangements that can ensure effective maintenance and management of common areas.

Additional References

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