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The dynamics of the formal urban land market in South Africa

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EXECUTIVE SUMMARY

This study aims to explain the dynamics of the formal urban land and property market in South Africa. This is an ambitious undertaking in a complex and rapidly evolving market and institutional environment. The result of this work we believe provides a good overview of the conceptual basis, the structural underpinnings and the operational dynamic that characterises the formal urban property market. It also provides an insight into the relevance and potential value of the market as a contributor to the fulfilment of the South African government's urban housing supply and transformation objectives.

The framework of the market - its institutions, drivers, rules of the game, and players – represents a powerful mechanism which governs formal sector property transactions in urban areas of South Africa. It acts as an efficient and predictable allocation instrument which, in those sectors of the urban economy which are not characterised by poverty and informality, has been observed to operate effectively within and across the different property market sectors. At the same time, the analysis reveals limitations to the market's ability to address the deeply rooted income, access and spatial distortions in South Africa's urban property market, and in its ability to address the backlog of supply and access at the poorest ends of the property spectrum.

The effective operation of formal property market institutions and instruments depends on the fulfilment of certain fundamental risk and reward relationships and requirements. At the root of these relationships, and a pre-requisite for their fulfilment, is the basic requirement of *affordability*. Where affordability is below the ability of market players to supply accommodation options for a competitive return and at an acceptable risk, the market will cease to operate. In the South African context, and for reasons associated with the country's legacy of discrimination and exclusion, the market currently excludes large numbers of people from participating directly in and benefiting from its operation. Their inclusion will in the long run depend on a pace and pattern of national economic growth, and the extension of employment levels and per capita incomes to a much larger proportion of the population who are currently either unemployed or contribute marginally to the formal economy. In the immediate term, bridging the affordability gap requires a significant injection of state resources into the housing market in ways which both increase the supply of housing and improve poorer households' access to and the affordability of a variety of accommodation options – whether through ownership, rental or settlement upgrading. In this respect, the state at various levels has invested significantly and in a variety of ways in increasing supply and overcoming the affordability and access gap. Given the scale of the backlog, direct subsidisation of poor people's access to housing will remain a continuing core function of the state for the foreseeable future.

Our analysis suggests that, while there are clear limits to the market's ability to effect pro-poor outcomes, particularly at the bottom of the affordability pyramid, it has a major role to play. Where there is a strong alignment between the operating and regulatory environment created by the state and the inherent risk/reward logic that drives the market, the delivery of pro-poor market outcomes can be significantly enhanced. Where this does not apply, and the regulatory and policy environment is at odds with the principles governing the market's operation, market activity will be compromised and its overall effectiveness and potential as a complementary supplier of housing solutions to the lower end will decline. The state's ability to address the scale of the urban housing backlog effectively and sustainably also depends on the extent to which its resource transfer and subsidy framework make use of and work with the market, rather than in isolation of it. This will in turn inform the make-up of appropriate public-private partnership options, as well as the development and extension of the existing housing investment and subsidy regime to be more market-compatible and incentivising.

Clearly this does not suggest that market-based approaches to pro-poor housing challenges are the only basis for state intervention. Widespread poverty and the skewed structure of incomes and employment fundamentally disable the market from directly contributing to meeting the housing needs of significant sections of the population; typically those who exist outside of the formal economy. However, the power of markets to leverage state resources and outcomes, even at lower levels of affordability and in an incremental fashion, remains significant. This report defines the framework of the market's operation and some of the mechanisms through which it might be harnessed to extend the reach and impact of the state in effecting solutions to bridge the gap and address the shortfall.

The report is divided into four main sections. Section 1 begins with a conceptual definition of how the formal property market works, and an elaboration of the logic that underpins it. It describes the market in terms of the operation of four well defined and interlinked market segments – space, capital, development and land. The effective operation of the market as a whole depends on the operating circumstances in each segment.

The analysis reveals that different sectors of the property market – residential, commercial, industrial - compete against each other for land, resulting in specific and changing spatial outcomes. The market allocates land between different uses and sectors according to the principles of competition, comparative returns and, ultimately, the equation of demand and supply. This manifests itself in the principle that, within a particular socio-political framework, the market will tend to allocate land according to its 'best and highest use', as this is reflected in and dictated by the financial returns that are associated with different possible land-use applications.

The institution of 'the market' essentially represents an intricate network of rules, conventions and relationships – 'the rules of the game' - that together represent the system through which property is used and traded. These rules in turn reflect the outcome of the interplay between different interests and players in the property market. Over time, these rules become codified into laws which are needed to guard against abuse by certain players or interest groups which may seek to create and exploit unfair advantages through collusion and anti-competitive practices. Through regulation and legislative intervention the state can readily change the rules of the game. Depending on their impact on incentives, risks and rewards for different players, economic outcomes can be expected to change in any number of ways and will ultimately manifest in increases or decreases in demand and supply. Through the interaction of its institutions and organisations, and through intricate cause-effect linkages that prevail between its various segments, developments in any segment of the property market, whether internally or externally induced, will result in particular – and frequently predictable – outcomes across all segments. This in turn will manifest in changes to the spatial form that the property market takes.

The state's planning function serves to condition, channel and direct the market's internal rules and activities in relation to social and economic objectives. These interventions can be highly effective in enabling market activity and in incentivising the fulfilment of social outcomes. This was the case, for example, in the incentive-based upgrading, transformation and enhanced supply of more affordable commercial and residential accommodation that occurred in SA's inner cities over the past ten years. Equally, where planning interventions (or regulatory inaction) are fundamentally at odds with the logic of the market, the risk/reward relationship that underpins market activity may become distorted. If they persist, these distortions will tend to compromise market-based activity and result in the departure of market players from the affected sector or segment, causing increased reliance on state resources and institutions for delivery. To some extent, this trend is beginning to manifest in many inner city areas, as private developers and rental providers experience lengthening delays, uncertainty and increased enforcement costs associated with their development and letting functions.

To anticipate and influence such outcomes, the study suggests that policy makers need to have a good understanding of the particular logic, institutional arrangements and the rules of the game that govern the property market and its various segments. This will help to maximise the impact of state interventions and will facilitate the design and delivery of effective incentivising instruments and regulations. By contrast, interventions which are not founded on an understanding of the market's logic can have sub-optimal outcomes – either because they underestimate the market's pre-existing willingness and ability to undertake activity, or because they may displace potential market activity which would support the fulfilment of the state's objectives. The power of the market can cut both ways. It is therefore important for policy makers to understand its logic, so as to be able to help determine the extent of its operation and the nature of its outcomes. The challenge for policymakers thus lies in changing the rules of the game to direct market activity into new areas and population segments without compromising the principles under which these markets function.

Section 2 summarises the size and operating characteristics of the formal urban property market in South Africa. Market data assembled as part of the research suggests that across all the major cities surveyed (Johannesburg, Durban, Bloemfontein, Cape Town and Nelspruit), house prices have not grown in a uniform way. Certain suburbs have experienced stronger price growth than others, with some suburbs experiencing growth below inflation or even in the negative. Notwithstanding the many possible reasons for negative price growth, the upshot is that over the past ten years these suburbs have become more affordable in real terms. They thus increasingly represent a point of formal market entry for households who have been historically excluded from access and ownership. The only exception to this pattern is Nelspruit, where relatively few suburbs have declined in price, largely as a result of the sustained strong economic growth the city has experienced over the past ten years (mainly as a result of the Maputo Corridor).

In addition, the data presents evidence of a significant overlap in the property prices of different suburbs and townships, across all metropolitan areas. This suggests that households who currently live in township areas are increasingly able to afford better located property in formerly white suburbs. There are therefore increased opportunities for mobility between former ‘township’ areas and formal suburbs as access to employment and income opportunities have begun to normalise. The household income needed to purchase housing at the lower end of the market is well within the upper limit of the Financial Sector Charter affordability bands (which in 2007 had an upper limit of R8,800 p.m.), and in some cases is as low as R5,500 p.m. Such households now also confront a relatively broad choice of residential accommodation opportunities at these levels, across a variety of suburbs and locations.

This information is significant in that it indicates the downward extension over the last ten years of the private residential property ‘ladder’ in South Africa’s main cities. The extent to which this is being met by a concomitant increase in property acquisitions by an emerging class of property owner is unclear, as data on sales volumes in these suburbs was not available. Moreover, it is clear that despite the increased affordability of some suburbs, many urban South Africans do not qualify for mortgage finance and therefore cannot afford to enter the formal housing market, even at the bottom end. But for those who can, both the affordability of metropolitan housing and the range of residential suburbs from which to choose are improving - without any obvious direct state intervention. The ability to move up this ‘ladder’ and the efficacy of its operation will crucially be influenced by the access which new entrants have to market information, and the availability of appropriate financing products from the formal financial institutions. This is an area where targeted public-private partnerships should be explored and are likely to have a significant impact in terms of deepening and widening the entry points to the bottom end of the formal property market.

It is difficult to determine the extent to which the enhanced affordability of low-end formal suburbs has actually translated into a process of upward ‘filtering’ of historically excluded households into formal suburbs – or whether and at which point in the price spectrum this filtering process might stop. Additional research is required. Anecdotally, however, the demographic and socio-economic transformation of many low-end suburbs has been evident across all SA cities. There is every reason to anticipate that this process will intensify and broaden with continued economic growth and formal employment creation – i.e. as the number of people qualifying for basic-level mortgage finance increases. Moreover, the evidence indicates that the insurmountable price barriers or ‘cliffs’ which historically hindered mobility between townships and residential suburbs are in the process of being eroded.

In the commercial sector, the evidence suggests that the market similarly offers space across numerous nodes and at different rentals. This makes it possible for entrepreneurs at the lower end of the price spectrum to enter the office market at rentals that are at least half those of prime area rentals. However, at around R55/square metre, even the lowest formal office rentals will be prohibitively expensive for entrepreneurs and small businesses which operate at the base of the formal sector – and certainly for those in the informal sector. In practice, market players at this end respond by formal and informal sub-divisions of available space, as well as by combining office with residential space, although the extent to which this has happened in the commercial market is difficult to measure. What is clear is that access to formal office (and retail) space is contingent on businesses being of a size and commercial status which by definition is beyond the reach of poor operators and entrepreneurs.

The challenge that these findings present for policy is in our view one of channelling significant direct resource transfers, incentives and enabling regulatory interventions toward the lower end of the commercial and residential markets. The focus should be on market-based interventions that bridge the gap between the bottom end of the formal property sector where the market works relatively well, and those segments which lie immediately beyond the market's operation – i.e. to maximise supply and facilitate effective demand. This implies the targeted use of fiscal measures and direct subsidies both to stimulate supply and facilitate effective demand, as well as the improvement and simplification of the regulatory environment so as to create a more secure and certain framework for developers and commercial letters willing to invest in these sectors and provide solutions at the lower end. The evidence from such initiatives to date suggest that this will serve to broaden and deepen access by historically excluded households to the bottom rungs of the formal commercial and housing property ladders, whether through rental or direct ownership, and to extend the downward reach of the ladder as a whole.

<u>Section 3</u> sets out the history and content of the policy, legislative and regulatory framework that governs the urban property market in South Africa. It begins with setting out the Constitutional mandates around land and housing and then describes where powers and functions lie for each. In addition, it sets out the policies that have been, or are being proposed to meet government's imperatives.

With respect to land issues, government is responsible for land administration, which includes all the normal processes of township establishment, land titling and so on. Ensuring that land is properly administered in the country is one of the state's fundamental roles as it is key to the effective functioning of the property market. Government should be highly concerned that land administration has become less efficient over time, which unless addressed, will eventually negatively affect the operation of the property market.

With respect to government's land and housing policy, both are being used to influence and shape delivery in line with specific targeted outcomes. A 'golden thread' of themes and outcomes are therefore woven throughout the state's policy documents. These include the spatial integration of cities and towns, reduction of economic inequalities, transformed patterns of ownership and asset creation, participatory planning processes, creation of 'sustainable human settlements' and the promotion of urban densification and 'social inclusion'. Each of these themes is manifest in an ever more complex policy framework, which in terms of local-level implementation can give rise to policy contradictions, conflicting priorities and market confusion.

Reflecting this, our research indicates that government policy has become more interventionist over time. In the early days it relied on a relatively simple policy, the Housing Subsidy Scheme, to address the housing backlog in the country. Unhappiness with the location of private sector-delivered housing projects has led government to look at housing delivery in a much more deliberate manner. And, resulting from this approach, it has required local authorities to develop more explicit guidelines around future development, especially around housing location and land usage.

This approach has not resulted in the satisfaction of government's transformation aims and so it has developed a number of more prescriptive policy responses, e.g. Integrated Development Plans and Housing Sector Plans, which require that local authorities carry out participative planning processes. These processes will require the balancing of the needs of a range of constituents, rather than leaving the private sector to proceed in an unfettered manner as had previously been the case. Land usage will therefore become much more contested than it has been in the past.

As government proceeds down a more interventionist track, our consultations revealed concerns as to whether untested proposals around, e.g. the establishment of a land development agency, a tightening of expropriation legislation and an 'inclusionary' housing policy, will not lead to the withdrawal of market players and a weakening of the market's capacity to contribute to urban development solutions. At the same time, there are important examples of government pursuing approaches which have incentivised rather than 'compelled' actions on the part of the private sector. Specifically, government's Urban Development Zone tax incentive has been highly effective in encouraging the private sector to carry out government's aim of urban regeneration. This represents an important case study of the government's capacity to leverage the market's power in the fulfilment of its social objectives. It is a prime illustration of the need for government in its dealings with the private sector to be guided, as far as possible, by the principle of 'incentivising' actions, rather than 'prescribing' actions which might be at odds with the logic of the market, and hence its ability to function effectively.

Finally, the section highlights the fact that the government's increasingly interventionist approach has resulted in a policy framework that has become more complex over time, imposing an increasing management burden on its capacity at both the local and national level to implement its core planning and management functions. This is resulting in a slow-down in the urban planning, investment and development process, with negative consequences for the nature and scale of continued private sector participation in this market. The section concludes by identifying the main areas of concern which government needs to address to ensure that the market's contribution to the process of urban development and continued growth is not compromised. These are summarised as being:

- contradictory and competing roles and responsibilities across spheres and tiers of government (DLA, DoH, DPLG), which result in inefficiencies;

- confusing policy and legislative prescriptions (DFA, Ordinances, LEFTA, PFMA, MFA and EIAs), which add to uncertainty and development costs;

- unclear and in many cases contradictory development priorities (house the poor vs protect the environment), which result in conflicts that slow down delivery and raise costs;

- slow policy and legislative processes (Land Use Management Bill, Housing Development Agency Bill, Inclusionary Housing Bill), which create uncertainties for investors;

- untested proposed interventions (HDA, 'inclusionary housing', expropriation), which could lead to the displacement of private players and the erosion of the market's investment, development and supply capacity ; and

- poorly capacitated and increasingly burdened local authorities already unable to keep up with the core planning and development processes, which lie at the heart of the market's ability to function effectively.

The overall themes highlighted in the above analysis are summarised in Section 4, following which the report concludes by presenting a number of recommendations for consideration, both at a generic and an issue-specific level to address the challenge of making the South African property market more effective in meeting the housing and accommodation needs of people excluded from it. These include specific research and development options which Urban LandMark might consider in taking forward its research agenda independently or in partnership with an appropriate statutory, NGO or private sector partner(s).

The issue-specific research recommendations we highlight are summarised as follows:

- Verify the extent of the operation and reach of a residential property market ladder at the bottom end of the formal urban residential market, the affordability and income bands this extends to, and the extent to which this reflects the operation of an active upward market-filtering process across metropolitan areas

- Explore the scope for and features of a demand-side subsidy mechanism aimed at bridging the gap that persists between informal housing and the bottom rung of the formal housing market, and specifically housing funded entirely through government's subsidy mechanism.

- Explore the feasibility and likely impact of rates- and/or tax-rebates as instruments for incentivising the densification and transformation of urban residential areas. These should be compared to the design and likely impact of government's existing inclusionary housing proposals with a view to understanding the comparative costs and benefits in terms of public investment, likely market impact and the likely consequences in terms of densification outcomes.

- Explore the feasibility and impact of the redesign and extension of UDZ incentives to small businesses, NGOS and individuals (all of whom are effectively excluded from benefitting currently from these otherwise highly successful incentives) across all property sectors

- Explore the feasibility and the likely impact on affordability and accessibility of implementing a mortgage income tax relief scheme for first-time buyers at the lowest bands, i.e. at the entry point, of the formal house price market. This might incorporate an assessment of other subsidy instruments to enhance the affordability of the formal housing market, such as the implementation of finite and declining interest rate subsidies for first-time buyers at the bottom end of the formal market. The purpose of such measures would be to extend the reach of the formal market by improving its affordability, particularly in the early years of ownership when first-time buyers are most susceptible to interest rate fluctuations and when certainty regarding mortgage payments is most needed.

- Explore the relevance and impact of applying established mainstream investment facilitation instruments, such as debt securitisation, to the low end of the formal mortgage market, with a view to lowering the risks and costs associated with bank lending in these market segments. This research could identify the extent to which these instruments require or will be enhanced by risk- and cost-sharing financing partnerships between government and the banking sector.

- Together with the appropriate statutory authorities, conduct regulatory impact assessments of key policies and legislation in place or in prospect, to assess their impact on the market's ability to function effectively and to contribute to meeting the needs of the urban housing and accommodation backlog.

1. THEORETICAL FRAMEWORK

The South African property market is best delineated and described in terms of its constituent space, capital, development, and land market *segments*. These segments are unified through an overarching institutional framework characterised by the laws, policies and regulations that affect property transactions and developments across the formal land market. This, the property market's *institutional environment*, is in turn influenced by socio-political arrangements which play themselves out at a macro and micro level, and which result in specific market outcomes.

This section describes the operation of the property market by means of a conceptual economic framework, out of which analytical tools are developed and subsequently applied to understand the operation of South Africa's formal urban property market. This analysis is presented in three separate sections. The first focuses on the characteristics of the South African space, capital, developmental and land market segments which underlie the dynamics of the property market as a whole. This is followed by a section that places these segments within a socio- political and economic framework. Finally, we consider the features and dynamics of the overall institutional framework that conditions the operation of the property market.

1.1. CHARACTERISTICS OF THE SPACE, CAPITAL, DEVELOPMENT AND LAND MARKET SEGMENTS

Decisions in the South African property market are co-ordinated through four segments. These are the space, capital, development and land segments.

In the *space* segment users decide on the quantum, quality and location of space required to meet specific socio-economic objectives. This in turn influences the location of offices, a housing development, a retail node, or an industrial park for the purpose of conducting business. On a daily basis myriad companies and households attempt to make optimal locational decisions, based on available information, in the space segment, taking account of a complex and changing array of variables which are of an economic and social nature. This means, for example, finding an office that is not only close enough to clients, but which is also accessible to employees. Similarly, the street hawker searches for an optimal location informed by the market as well as institutional factors such as street trading bye-laws. Therefore, players in the space market make decisions and interact within a space market that is characterised by a specific economic and social and legal framework. A change in this framework will influence players' access to the space market and opportunities within it, as well as outcomes in the market itself. The *capital* segment provides the equity, debt financing or the funding required for the property market to function effectively. The availability of mortgage finance is, for instance, important in determining whether housing needs can be translated into effective demand. In the case of commercial developments the capital segment plays a critical role in determining property values because such investments are primarily acquired for their income-generating potential, and tend to be valued in relation to their projected income streams or yields. These yields are in turn influenced by reigning interest rates and related conditions and expectations that inform the operation of the economy's capital markets. As in the case of the space market, the access that players in the property market have to the capital market will vary considerably. This access is influenced by the type of financing products that exist in the market and the properties that are financed by the banking sector

The development segment supplies the market with different types of properties and it is also in this segment that decisions are made regarding the location of future supply. In turn, development activity translates into a demand for land in the land segment, where one witnesses the final outcome of the interaction between demand and supply factors in the other three segments. The above process might be illustrated graphically as follows:

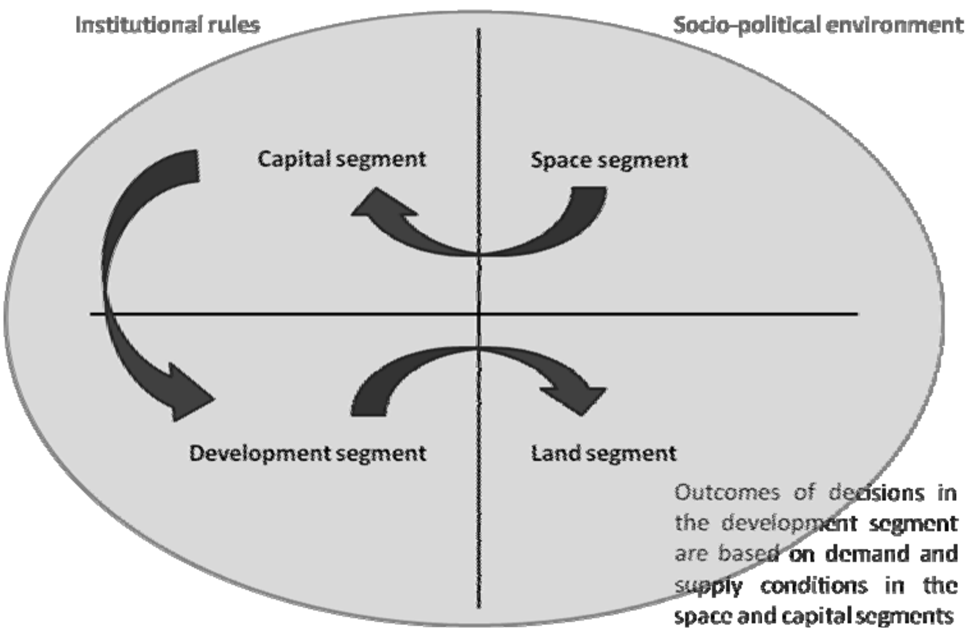

Figure 1: Segmentation of the property market

Source: Genesis Analytics

1.2. THE SCHEMATIC MODELING OF THE PROPERTY MARKET

The overall market-interaction between the space, capital and development segments can be illustrated in terms of a four-quadrant model depicted in Figure 2.

The first quadrant (the space segment, top right) shows supply and demand conditions[1] in the space segment. The rentals associated with properties are depicted on the vertical axis and the quantity of properties demanded/supplied is depicted on the horizontal axis. Equilibrium in this market is at point ***e***. At this equilibrium point, the quantity of properties/space demanded is ***Qe*** and the rental thereof is ***Re***.

An increase in the demand for space caused by, for instance, a successful urban regeneration programme, an increase in household income, or an improvement in market accessibility by households , shifts the demand curve outwards, with the new demand curve now depicted by $\boldsymbol{D^1}$. As a result, the demand for space rises to $\boldsymbol{Q^1}$ and rentals (or the price of properties) rises to $\boldsymbol{R^1}$. In the short term, the supply curve cannot be altered as supply will only shift once the development segment has reacted to the new demand and supply conditions – this is always a lagged process which is influenced by the quality of information that reaches decision makers, the way this information is used and the market expectations that this information has created. If the risks associated with a potential development reflect expected returns, the development will be undertaken and supply increases. An improvement in economic conditions may also increase the demand for housing units and push the demand curve outwards, resulting in higher property prices. This assumes that supply does not react immediately to these higher prices. The linkage that exists between the different sectors of the market often occurs on a lagged basis as it takes time for information to flow from, for instance, the space market to the capital market and ultimately to the development market. It is also because of such lags that property cycles exist in the residential and commercial property markets – as the delays associated with information flows and subsequent market reactions reinforce and enhance pre-existing trends, exacerbating the underlying cyclical basis to the market's operation.

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[1] The supply curve is an upward-sloping curve indicating a positive relationship between the price of a product and the quantity supplied of that product. Thus, as price increases along the vertical axis, the quantity supplied (on the horizontal axis) will also increase, and vice versa. The downward-sloping demand curve indicates an inverse relationship between the price and quantity demanded of a product. Thus, as price increases (vertical axis) the quantity demanded (horizontal axis) will decrease, and vice versa

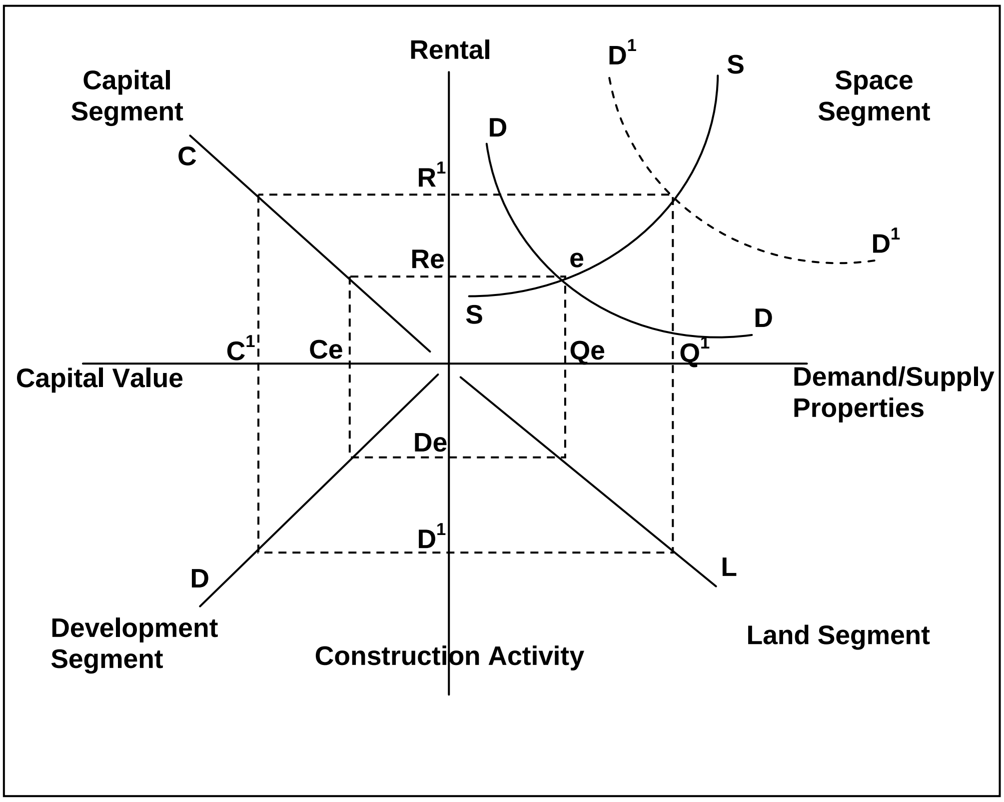


Figure 2: The Four-Quadrant Model

Source: Viruly

The second (top left) quadrant depicts the capital segment of the property market. As discussed previously, it is in this segment that rental values derived in the space segment are converted into capital values. The conversion occurs along a vertical line which illustrates the yields (returns) that investors expect. These yields are directly influenced by prevailing interest rates and overall sentiments regarding future prospects for the property market.

Thus, in the office sector, rental value ***Re*** is translated into a value ***Ce*** in the capital segment. The higher the rentals generated by a property the higher its capital or market value. If rental values rise to $\boldsymbol{R^1}$, capital values rise to $\boldsymbol{C^1}$ – the line ***C*** tracks this movement, and its gradient is a function of interest rates, internal banking policies/regulations, perceived risk etc. In the residential property market, a declining interest rate environment reduces mortgage-related costs such as bond repayments, thus increasing the demand for housing and causing residential house values to rise.

The third (bottom left) quadrant reflects the development segment and illustrates the relationship between property values and property development: as property values rise (caused by changing conditions in the space and capital segments), developers react by increasing development activity. This is based on the argument that if property values rise, and development costs remain constant, the viability of projects improve and, depending on future market expectations and reigning town planning regulations of investor and developers, this should result in a rise in building activity.

Thus, in the bottom left-hand corner of the four-quadrant model, a capital value ***Ce*** will result in an amount ***De*** being developed. As capital values rise to $\mathbf{C^1}$ the level of development rises to $\boldsymbol{D^1}$ – line ***D*** tracks this movement. The position and gradient of this line (***D***) in the development segment will be influenced by issues such as building costs and available building technologies. For instance, a much steeper line would indicate high building costs resulting in a relatively smaller increase in development activity when capital values rise by an equivalent amount. While the model explains the factors that drive property developments, it does not explain the location of developments, the type of developments that will be undertaken and who will undertake these developments. ,

The outcome of development activity is illustrated in the fourth, the land quadrant, (bottom right) which links the development and space segments. A rise in development activity will, at some point, shift the supply curve in the space segment outwards, resulting in a decline in rentals. This will result in lower capital values and a slowdown in building activity, bringing the market into equilibrium. All these interactions are depicted by movements along line ***L*** in the land segment and are further explained in Figure 3 below. That this is not always rapidly achieved is hardly surprising given the complexity, leads and lags of the property market, and raises interesting questions regarding dynamic adjustment in the formal property market.

Although not directly depicted in the four-quadrant model, a rise in building activity increases the demand for land in specific geographic markets. In Figure 3 it is assumed that the supply of land ***S*** is constant in the short term. An increase in development activity will shift the demand for land to $\boldsymbol{D^1}$ resulting in the price of land rising from ***P*** to $\boldsymbol{P^1}$.

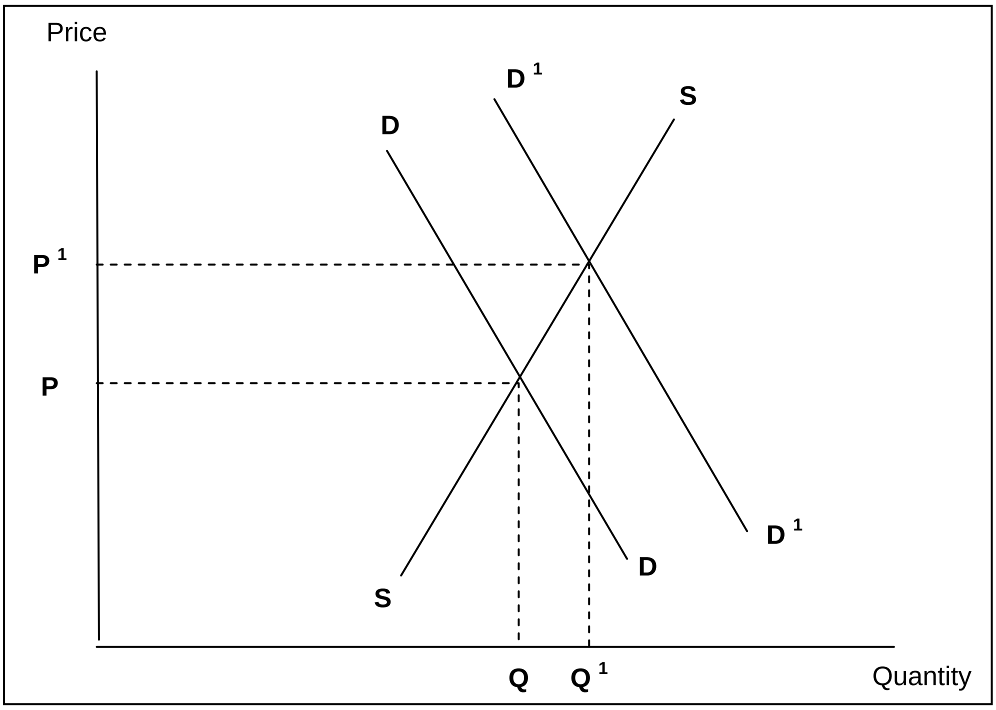


Figure 3: Short-term dynamics in the land segment

Source: Viruly

If the planning regime becomes less restrictive, it eases land supply and shifts the supply curve in Figure 3 to the right, and thereby reduces land prices. This stimulates development activity which in turn increases the supply of space. An increase in the supply of space offers the potential to improve affordability in both the residential and commercial property markets. If the public sector spends more on infrastructure or public transport, for example, it improves accessibility to land and has supply-side effect – because it opens up new locations for development and reduces development risk. Thus, by influencing conditions in the land market, the public sector can influence the spatial direction of the property market and even influence the type of developments that developers will undertake.

The important observation to consider is that the dynamics of the property market can be stimulated by conditions that originate in different segments of the property market. These include conditions in the space segment that alter demand for space, rental values and ultimately prices; conditions in the capital segment, such as an increase in the interest rates and yields; and conditions in the development segment itself, such as a rise in building-related costs (including land) and building-related regulations.

The economic model presented above is useful in order to identify the interplay of factors that influence property rentals, values, the level of development and the demand for land across all market sectors. It is also useful in the sense that it informs how government intervention in the property market works itself through the market - via market signals and consequent decisions taken by different players in different segments of the property market.

At points throughout the report, the model is used to explain and analyse different market interventions. Especially from a policy perspective, the model goes a long way towards explaining and predicting the consequences of market interventions in the space, financial, development and land segments. More importantly, it illustrates that an intervention in the space market can easily be compromised by conditions in other segments of the property market.

1.3. DYNAMICS OF THE MARKET SEGMENTS

1.3.1. THE DYNAMICS OF THE SPACE SEGMENT

The space segment in the property market can be analysed in different ways. At an aggregated level, the property market is divided between residential and non-residential properties. At the next level, properties are categorised by property type and the income/business groups that they serve. For instance, formal residential property types vary from RDP homes at the lower end of the market, to cluster developments, sectional title developments, single standing homes, and high-density homes (see Figure 4). In the residential space segment these property types are offered to different users who tend to be defined by socio-demographic characteristics such as income, age and family size. The access of market players to the different segments of the property market will vary. Thus the access of homeowners in the RDP housing market to the financial and capital markets will be different to the access that households at the upper end of the residential market experience. This suggests that the institutional framework that encompasses the space, capital, development and land segments leads to specific market outcomes.

The South African commercial property market is divided into four distinct property types, namely office, retail, industrial and other uses which include hotels, show rooms and a range of other applications (see Figure 4). These sectors have specific and distinct characteristics and locational requirements. While location close to a CBD is of critical importance for an office development, the attractiveness of an industrial site will be more sensitive to highway accessibility, accessibility to providers along the supply chain, electricity and land values.

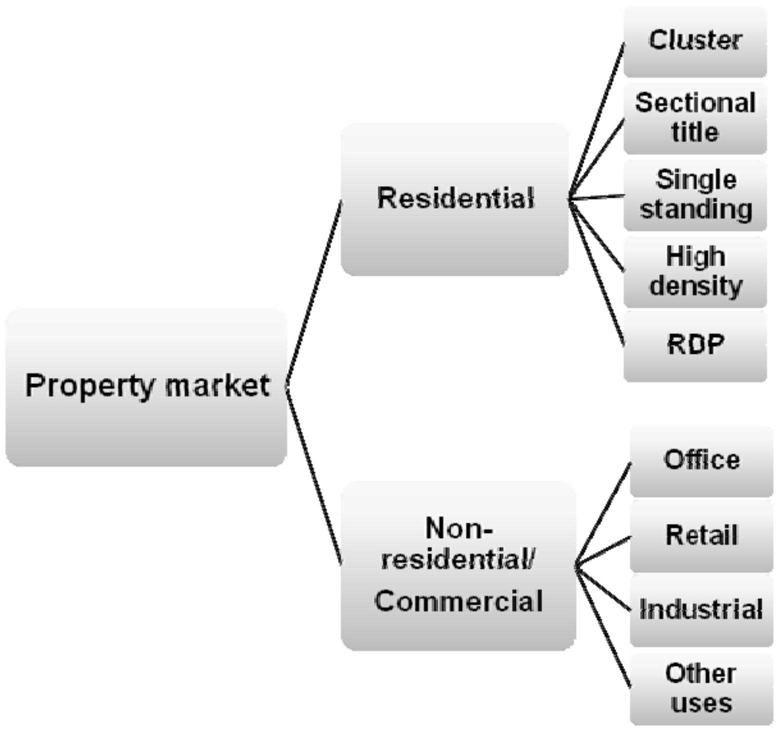


Figure 4: Composition of the formal property market
Source: Genesis Analytics

In the residential property market, demand is primarily a function of household income, transport costs and proximity to work, as well as social amenities such as schools and clinics. Public sector policies that impact on the availability of physical and social infrastructure have, therefore, a profound impact on where residential units are developed and whether they remain affordable, and reflect the needs of households in that sector of the market. Typically a project such as the Gauteng rapid rail (Gautrain) project will, by influencing accessibility to residential and commercial nodes, have an impact on both the residential and commercial property markets, particularly in the proximity of the main access points. Such projects also offer an opportunity to improve the accessibility of households to new areas of the city and encourage developers to consider opportunities in these markets. From a macro perspective, one should expect that a positive relationship exists between the strength of the economic base of a property market and the demand for space in that market. The strengthening economic performance of a metropolitan area should result in an increase for the demand of residential as well as commercial space. But even in a growing economy, the demand for space may be low in certain suburbs that have seen a decline in their locational attractiveness. This scenario may for instance occur in suburbs that have suffered from urban decay. Policies at central and local government level have attempted to redress such problems through urban regeneration programmes and Urban Development Zone tax incentives, both of which are discussed in later sections.

The supply side of the space segment includes supply that arises from building activity, as well as properties that enter the market from the existing supply stock. Annually, the supply brought about through building activity will tend to be a relatively small share of the overall market and the greater proportion of demand will be for existing space. Moreover, in a particular year some of the existing property stock will depreciate and even become obsolete. . This obsolescence can result from changing transport patterns, the deterioration of infrastructure, urban decay and the impact of policies that reduce the investment returns of existing properties. But with time, buildings that have become obsolete may find a new use, which may lead to their renovation or the redevelopment of a site – this is equally true for the residential and commercial property markets. For example, the Umgeni Business Park in Durban is a large warehouse that was converted into smaller units/offices that are now being let at R67/m^2 per month. In the Cape Town CBD, warehouses and offices have been converted for residential use.

The supply of new space to the market will be a function of property values, building costs, land availability and the expected returns that investors and developers are able to secure. City suburbs that experience high levels of demand will tend to experience a high growth in property values, which in turn results in such suburbs experiencing high levels of development activity. Demand and supply conditions vary from one sector of the market to the next, which also means that competition for resources exists between these different segments. The way that supply reacts to demand will be influenced by players' access to land and capital, as well as existing town planning regulations.

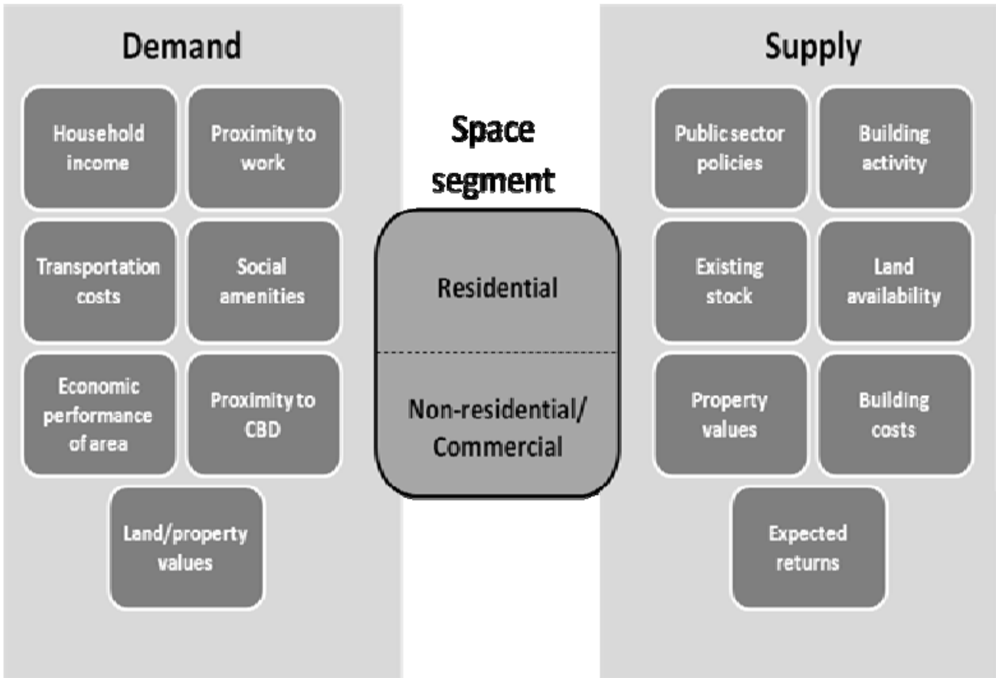


Figure 5: Demand and supply factors in the space segment
Source: Genesis Analytics

1.3.2. THE DYNAMICS OF THE CAPITAL SEGMENT

The capital or financial market segment, which includes the banking sector and investors, plays a critical role in ensuring the smooth functioning of the property market. Without an effective capital market, investors find it difficult to raise the necessary funding, and developers find it difficult to fund their development projects. In the residential property market, capital markets provide the mortgage financing that enables individuals to acquire houses. Since the property sector is heavily reliant on debt financing, and hence on affordability criteria, the banking sector influences the type, value and location of property developments and acquisitions across all sectors.

As an example, a decision by the South African Reserve Bank to tighten monetary policy through a rise in interest rates would, through its effect on raising the cost of residential mortgage loans, reduce the affordability of housing and ultimately the demand for housing. This would have a negative impact on the value of properties. However, the impact that an interest rate hike will have on the housing market will vary from one section of the residential sector to the next. One would for instance expect that the wealthier section of the residential market will be less sensitive to an interest rate hike than for instance the middle or lower end of the housing market. In this and other ways, the structure and operation of the capital market has a direct bearing on the operation of the housing development and supply market segments, which in turn will influence the dynamic of the space segment.

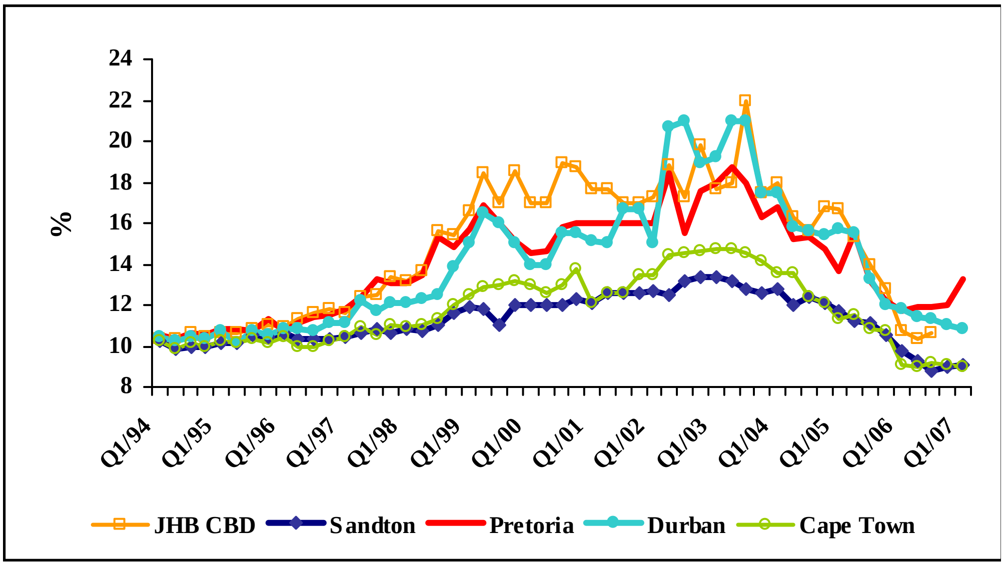
The availability of mortgage financing also plays a critical role in determining households' access to property markets. This is because a housing unit normally costs a multiple of annual household income. The availability of housing finance is not only a driver of demand, but also increases the ability of households to move up the residential ladder. Yet mortgage financing in developing countries such as South Africa is often difficult to secure because the default risk associated with lower income households is often perceived to be high within the context of the prevailing lending criteria. At the same time, the ability of households to secure a loan is often compromised by the terms and conditions associated with existing mortgages. As a result, loans for housing often come from relatives, employers and moneylenders, frequently at high interest rates and low levels of lender flexibility.

Access to mortgage finance is also often constrained by the institutional arrangements that drive mortgage loans. Existing rules and regulations as well as the products offered make it difficult for lenders to provide mortgages to households that do not meet specific criteria. The challenge lies in ensuring that financial markets serve the needs of lower-income households whilst paying the necessary attention to the balance between the - often opposed - requirements of lenders and borrowers. Solutions to these challenges lie in paying careful attention to understanding the characteristics of lower-income households and adapting financing products as far as possible to meeting their circumstances. This refers to, for example, the make-up and frequency of household income and the type of security /collateral that households can provide.

Increasingly, public sector interventions and institutions are playing a role in the facilitation of mortgage financing to lower-income groups. These initiatives have taken the form of government-sponsored housing finance institutions, often supported by direct budgetary transfers. Governments also provide specified lending targets for mortgage lending (possibly at below-market interest rates) by commercial lending institutions. In South Africa, government has particularly focused its attention on the lending targets for commercial banks included in the Financial Sector Charter.

In summary, the housing finance market operates within an institutional environment that often serves particular markets and income groups. Attempts at improving the accessibility of property financial markets will need to focus on developing property rights: ensuring that rights to acquire and freely exchange housing are established by law and enforced at all levels of the market, and particularly in areas not historically associated with freehold title, and developing and deepening mortgage finance products: creating healthy and competitive mortgage lending institutions, and fostering innovative arrangements for providing greater access to housing finance by the poor. In the case of the commercial property market, which is largely driven by expected investment returns, financial markets similarly influence the value of properties. A rise in interest rates will normally result in investors requiring higher investment returns or y*ields*, which in turn reduces the value of acquired properties – as their value adjusts downwards in order to satisfy the market's need for a higher yield to match the rise in interest rates. Expected investor returns are also affected by the perceived riskiness of property investments, with property risk being a function of conditions in the space segment as well as the probability that expected rentals and demand for space – both a function of macro-economic conditions - can be met.

This is illustrated in Graph 1, which suggests that commercial returns or yields vary from one geographic area to the next. While investors may be satisfied with a yield of 10% in the Sandton market, because market prospects in the area are attractive, similar properties in the Johannesburg CBD, which are assumed to have a higher risk profile, will have to offer a higher yield of say 12% to attract investors.

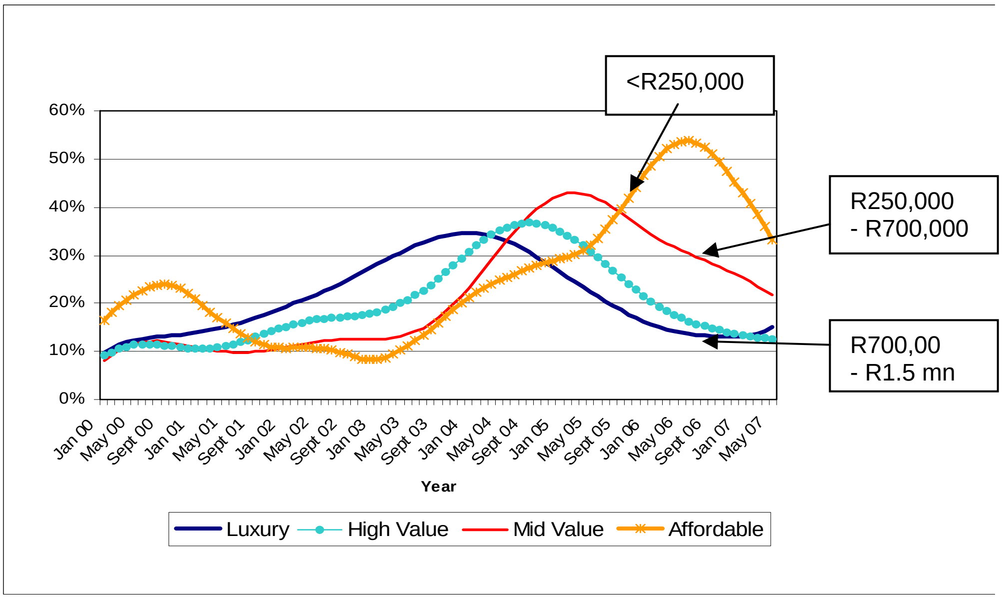


Graph 1: Office capitalisation rate (or yield)

Source: Rode/Viruly

An analysis of yields goes some way toward explaining why property values are higher in some areas than in others. Properties in attractive commercial nodes tend to attract more development activity to these nodes, and in turn enable local authorities to secure relatively high property rates there.

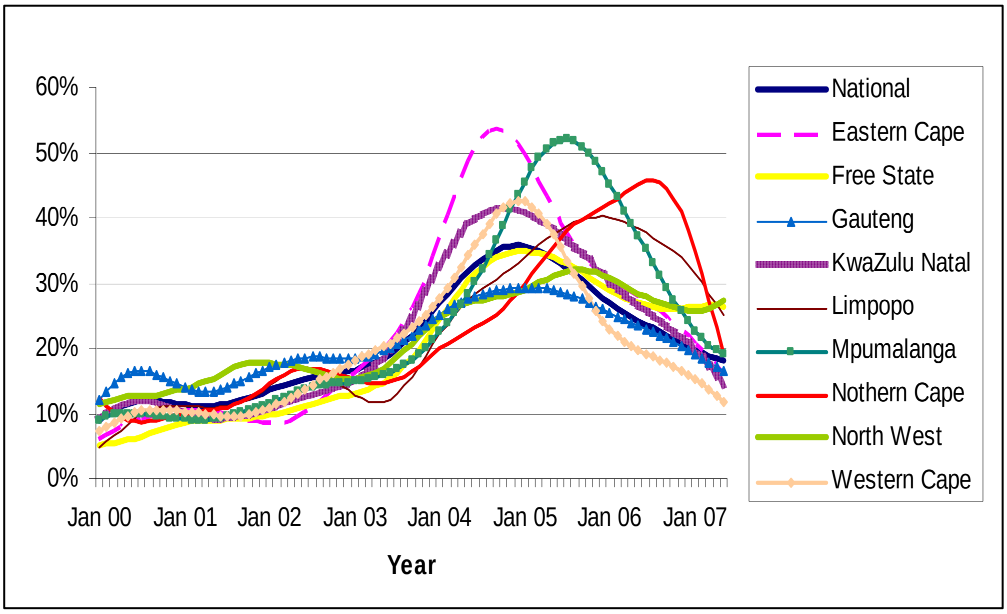
Graph 2 suggests the significant range in performance that exists between the higher and lower value extremities in the *residential* market. Thus, the lower and middle end of the market continues to show a strong performance, with capital values rising at a rate of between 20% and 30%. This is reflective of a shortage of supply in this segment of the market. Considering the recent rise in interest rates, affordability has become a problem in this segment of the market. This contrasts with higher value properties whose rate of growth has declined to lower levels.



Graph 2: House price growth across different bands of the residential property market

Source: Lightstone–index May 2007

Although the market below R 250,000 seems to be recording growth in property values in excess of 20%, the higher end of the market is showing half of this performance. The variation in the growth in residential prices across geographic regions is illustrated in Graph 3, with the Free State and North West provinces currently outperforming the market, probably reflecting a lack of supply.



Graph 3: Residential Property Indices

Source: Lightstone, 2007

Thus, property values, and therefore the affordability of housing are influenced by decisions in both the space segment (where rentals are determined) and the capital segment. While the demand for space is derived in the space segment (Figures 1 & 2), the determination of property *values* is influenced by conditions in the capital segment of the market. The underlying point is that the capital markets have a profound impact on property values, the ownership of properties and the level of development activity. In the residential property market, interest rate movements that arise in the capital markets directly affect the affordability of housing. In the commercial property sector, capital markets influence expected investor returns and, through this, ultimately determine property values.

1.3.3. THE DYNAMICS OF THE DEVELOPMENT SEGMENT

The performance of the property market in the space and capital market segments translates into a particular type and level of *development* activity. Players in the development segment carefully consider supply and demand conditions in the space market, as well as property values derived from the capital segment of the market. If the ratio between capital values and building activity is attractive and development risks are deemed to be acceptable, development activity will be forthcoming. Of course the ability to develop will also be influenced by factors such as town planning and the efficacy of other development related regulations.

It is therefore in the development segment that developers assess the possible risks and returns associated with new developments and decide whether to supply the market or not and whether certain markets should be targeted.

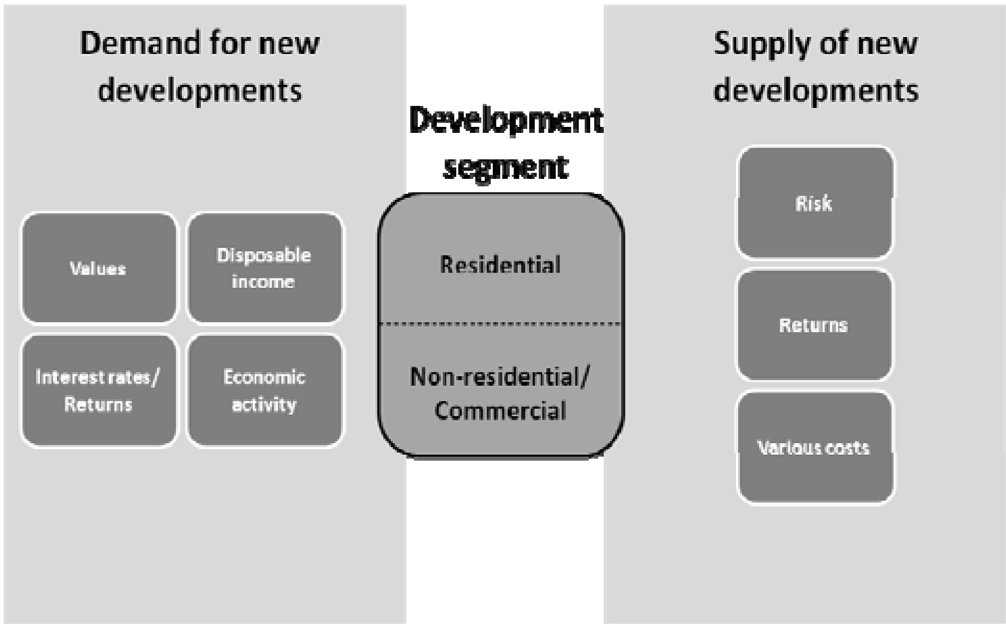


Figure 6: Demand and supply factors in the development segment
Source: Genesis Analytics

The property development industry conceives schemes, assembles land sites and builds properties. The completed projects are then sold on to investors or users, who hold the offices as financial assets or use the houses as homes or financial assets.

The primary objective of the developer is to assess the value of a completed property against the costs associated with the development of that property. Moreover, one of the challenges for the developer is also to ascertain the value of the developed property some time into the future. This will be based on future expectations regarding the macro-economy, rentals, capital values and building costs. In the case of large developments, the development period can extend to years rather than months into the future, which increases risk and the potential costs associated with the property market turning against the development.

In making a development decision, the developer needs to assess total development costs. This will include land, materials, labour, capital (the cost of financing the development), and administrative/regulatory costs – often referred to as transactions costs. The cost of land will be determined in the land segment (as discussed previously) and will be influenced by factors such as the town planning regulatory environment, the present and future availability of infrastructure and the competition for land between different uses. For instance, a decision by public authorities to bring public land to the market may alter land availability and the price of land - as supply increases, so its price will drop. The amount of land brought to different components of the market will depend on a number of factors. These include the level of competition that exists between different land uses as well as the availability of infrastructure and overall access to land.

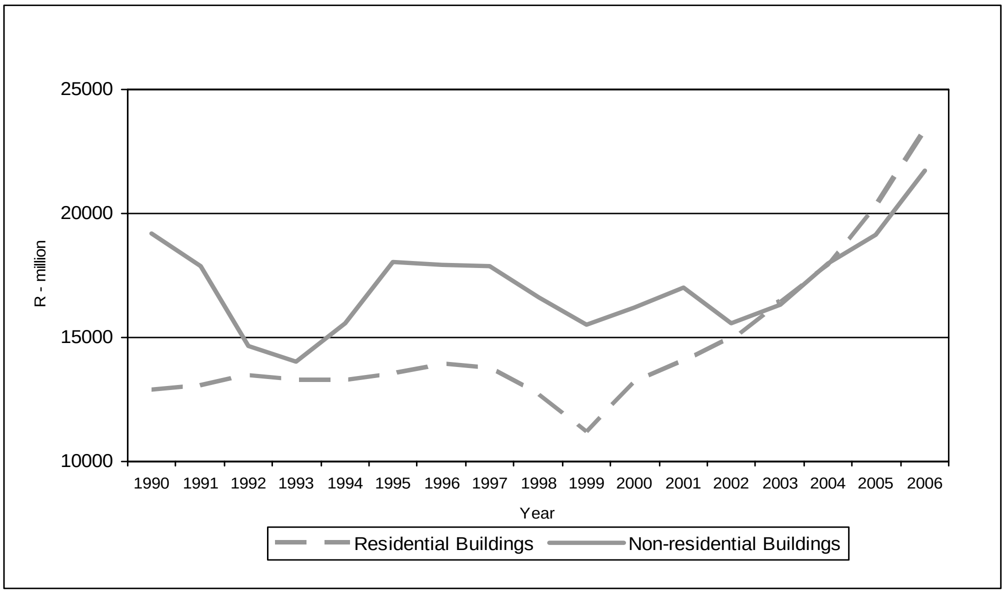
The cost of building materials and labour reflects demand and supply conditions in all four segments. Thus, the cost of financing projects will reflect conditions in the capital segment as well as perceived development risks. It means, for example, that in the latter stages of the property cycle, the banking sector will tend to be mindful of the risks associated with oversupplying the development segment and may reduce the availability of funding to the sector. As is the case in other sectors of the economy, the property sector goes through different phases. Towards the peak of the cycle demand will tend to be ahead of supply and vacancies will be relatively low. This will normally result in a rise in rentals and property values. In turn, this encourages developers to react to the market shortage through a rise in building activity. As the property cycle moves forward, supply tends to satisfy and then exceed demand, which causes rentals and property values to start declining. One of the major characteristics of the property market is a substantial lag that may exist between the property investment and development cycles. This is largely caused by the time lags that exist in initiating building activity as well as the time it takes for market information to reach the development segment of the market.

Apart from considering the direct costs of a development, the developer will also consider regulatory and related institutional costs, all of which determine the transactions costs associated with the development market. These include time delays and costs associated with rezoning of properties, acquiring necessary building permits and undertaking specialised property studies such as environmental impact assessments. A regulatory framework that is overly cumbersome, time consuming, unpredictable and expensive – i.e. is associated with high transactions costs - will reduce the viability of a project and will curb the appetite of investors and developers to enter the market. This will also influence the scale and types of properties that are developed, and where these developments are located. For instance, in the 1990s the cumbersome institutional development arrangements that came to characterise the lower end of the residential property market increased transactions costs and developmental risk, resulting in developers leaving this sector.

The South African property development segment is dominated by large as well as small players specialising in specific components of the market. As the barriers to entry in the residential development market are relatively low, the upper phase of the property cycle often attracts start-up developers who in turn leave the market within a few years, especially as the cycle turns down and the cost-return ratio begins to rise. The entry of new developers into the market, however, increases the risk of overdevelopment, as competition intensifies and margins and returns become squeezed. By contrast, in the commercial property market, risk, financing, management and technical barriers to entry are higher and development activity tends to be dominated by a few large players. This encourages a greater degree of specialisation, with certain developers for example specialising in the retail or office sectors, and others in the industrial or housing sectors.

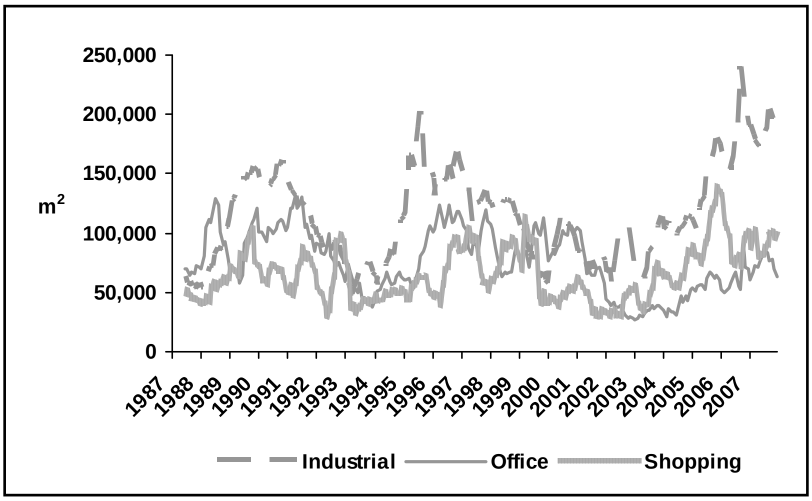
An indication of the scale of the development market is given by the fact that in South Africa, nominal gross domestic fixed investment in the residential and non-residential sectors was estimated to be in the region of R 69,2 bn in 2006. The residential sector was responsible for R 35,78bn (or 51%) of this total, followed by R 33,92 bn (49%) invested in the non- residential sector.

The graph below illustrates real building activity between 1999 and 2006, and in particular illustrates the growth in building activity over the past five years. This in turn reflects the favourable conditions in both the capital and space segments of the South African property market.



Graph 4: Gross domestic fixed investment in the construction sector (at constant 2000 prices)
Source: SARB – Quarterly Bulletin December 2007)

The cyclicality of the South African commercial development activity is illustrated in Graph 5. One can see that both the industrial and office sectors are showing strong growth, largely reflecting favourable recent market conditions in the non-residential space segment. This is a result of high rates of macro-economic growth and relatively low interest rates and inflation, all of which translated into high effective demand – across all property market sectors.



Graph 5: Total building plans passed

Source: Stats SA

As indicated in the graph, the developmental sector is highly cyclical. The nationwide overbuilding of the office market in the late 1990s sent vacancy rates to above 15%. As expected, these high vacancy rates left office rent growth rates flat to negative for a number of years. In time, low or flat office rentals will tend to ignite demand for space, thereby (together with other macro-factors) initiating a turning point in the commercial property cycle.

The foregoing analysis therefore clearly indicates that the space, capital and development segments are tightly intertwined. The interaction of the space and capital market segments explains the derivation of the demand and supply for space and development cycles in the property market. Rising capital values spark a rise in building activity, while lower capital values, caused by deteriorating conditions, including oversupply in the space and capital markets, result in lower levels of development activity. In this interaction lies the origin of the property market cycle, the features and causes of which are dealt with further below (section 1.5).

1.3.4. THE DYNAMICS OF THE LAND SEGMENT

The land segment is the last of the four interrelated property segments that influence activity in the property market. The land segment is also the segment that manifests the outcome of decisions made in the foregoing space, capital and development segments. The demand for residential and commercial space in the space segment, if enabled by the capital market, results in development activity and thus an increase in the demand for land.

Being the outcome of investor, financing and development decisions, the nature of the demand for land within and between property sectors will differ according to conditions prevailing in those segments, and will in turn influence the type and location of property developments in the market. The location of property developments results in an urban environment taking a specific structure or form. The availability of relatively cheap land on the fringes of metropolitan areas will mean that low-income and low-density housing will be located some distance from city centres. Similarly, high-value land will attract high-yielding and high-value property investments across all sectors.

Although town planning schemes have a role to play in determining land use, and therefore the location of developments, town planning authorities are rarely in a position for long to accelerate or slow down the demand for space in particular sections of the market. This is primarily because policy makers cannot consistently anticipate or forecast the spatial decisions made by private players in the space, capital and development segments. These players are driven by the highly intricate, dynamic and specialised interplay of risk and reward, whereas planners are typically not exposed to the penalties and rewards of this interplay. Nonetheless, it is clear that planning interventions can clearly influence the dynamic of the market, by reducing the competition for land by different sectors and altering the relative weighting of the variables in the different market segments. This influences market outcomes in these segments.

The supply of land can be segmented between land that has already been zoned (i.e. is ready for development) and land that could be brought to the market at some point in the future. At any point in time the land segment will comprise land parcels that have either not been developed or which are not being used in their highest and best use. In an urban property market, certain properties will no longer be reflective of investor returns and will be ripe for re-development or conversion. Other properties are left, often derelict, because they offer no alternative use. The developers will also have properties which have been rezoned but which await a development at some point in the future.

Another potential component of the land market comprises properties which could be rezoned from ‘agricultural’ land to ‘urban’ land, i.e. land which currently falls outside of the urban land market. The supply of this land will tend to occur in large ‘chunks’ and will be informed by the availability of factors such as infrastructure, transport and social services. The pressure to bring such land to the market will be influenced by the existing availability of zoned land, the accessibility of this land, and whether sufficient funds could be paid by a developer to transform unzoned land into zoned land through investments, *inter alia*, in bulk infrastructure and services.

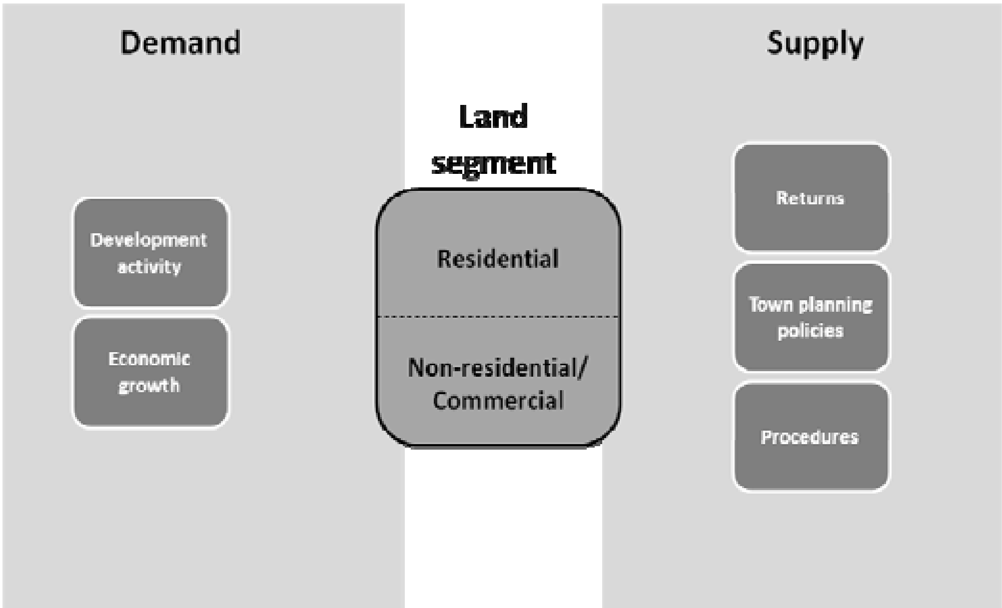


Figure 7: Demand and supply factors in the land segment
Source: Genesis Analytics

In the residential property market, the manner in which local authorities accommodate, respond to and design land requirements will have important market consequences. A shortage of available development land may, for instance, push developers into high-density developments. Recent evidence suggests that town planning interventions (such as the implementation of urban boundaries[2]), combined with stringent environmental regulations, have accelerated the rise in urban land prices and the viability of specific types of developments. Rising land values will influence the property market in different ways. For example, as land prices increase, developers in the residential sector will be encouraged to develop high-density, rather than low-density developments.

[2] See discussion on the 'urban edge' in the following section.

In all, decisions made by players in the space, financial and development segments are reflected in the demand for land and the manner in which land is allocated between different uses. Yet land and town planning policies applied in land markets potentially influence the level and type of development in a market.

1.3.5. LAND USE DETERMINATION AND THE INTERACTION OF DIFFERENT PROPERTY SECTORS

Apart from functioning in the space, capital, development and land markets, the different sectors of the property market compete for a limited supply of land. If markets were left to compete freely, the land use which can yield the greatest financial benefit or return from any particular piece of land should be in a position to 'outbid' other potential users. In practice, the level of competition between different land uses will be constrained by town planning, environmental and town planning legislation as well as the overall institutional environment in which the market functions In city centres. Developers in the office sector typically 'outbid' the price or land value – in turn a reflection of the expected return - which players in the residential sector, for example, are willing to pay for that land. The possible exception to this may be the developers of high-rise residential apartments which, because of their high density and consequent high value, may be able to compete against the office sector.

As one moves further from a city centre, the value of land for, say, office users declines and developers in this market are 'outbid' by other (e.g. residential and retail) users. This is based on the fact that, as a user moves away from an optimal location (the CBD for an office user), the value they are willing to pay for the property declines. Some sectors and users are more sensitive to location than others. For instance, a retailer would place little value on a property that is not well located from a market perspective, while a user of office space will tend to have greater flexibility in the location chosen.

The argument is illustrated in Figure 8, with land values depicted on the Y axis and distance from the demographic centre of the city depicted on the X axis. As one moves away from the origin (point O), one moves further away from the city centre. The diagram shows that at point A, the retail sector can pay a higher value than the office sector, whereas at point B the office sector is in a position to 'outbid' the retail sector. From a market structure perspective it also means that land between points O and B will tend to be used for retail developments while in the area between points B and C, the market will tend to allocate land to the office sector.

The diagram encapsulates powerful principles of the property market which are a fundamental driver of investment decisions within it, and therefore of the spatial outcomes and trends that result.

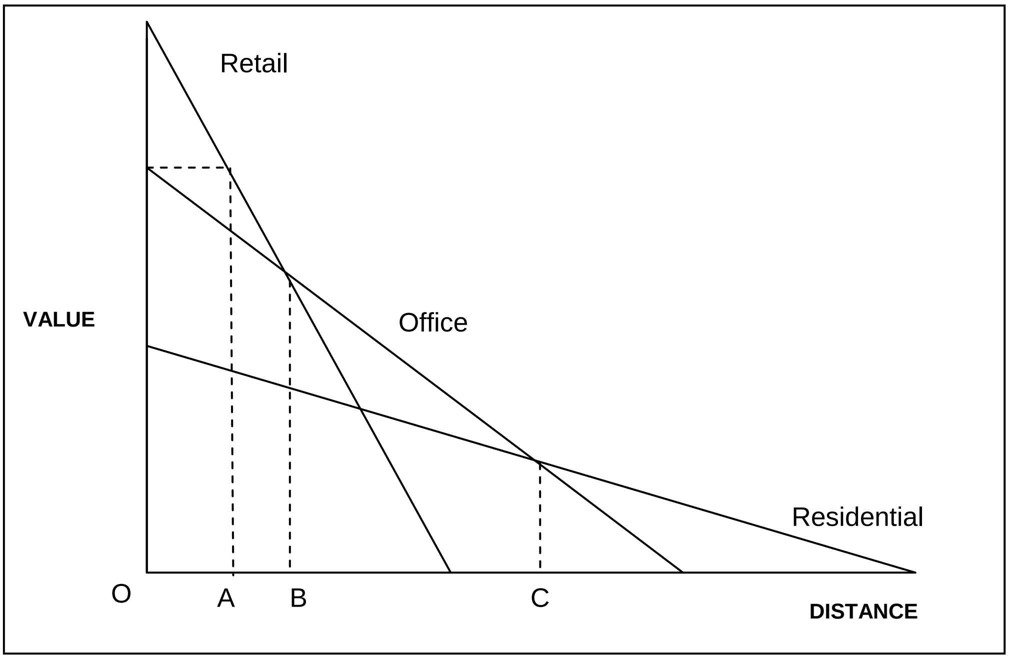


Figure 8: The competitive allocation of land between sectors

Source: Viruly

This analysis suggests that, if left to market forces, the property market leads to a specific allocation of land based on the highest and best use of each parcel of land. This market-driven allocation of land according to the ‘highest and best use’ principle may not necessarily serve the needs of lower-income households, who find it difficult to ‘bid’ against commercial users and high-income households. Gentrification of suburbs may for instance push low-income households out of particular suburbs and generally make inner-city living unaffordable.

While from a neo-classical economic perspective, land allocation is often depicted as an outcome of market forces, it is important to emphasise that the market operates within an institutional environment that has specific socio-political characteristics. Thus, the pattern of urban land usage will be influenced by the laws, regulations and policies that are the outcome of socio-political interaction. This is particularly well illustrated in the South African town planning environment, which is often defined by

Integrated Development Plans (IDPs) and Spatial Development Frameworks (SDFs) which are formulated through extensive public participation. Town planning functions have a further impact on the market in that they influence transaction costs and therefore the scale and type of developments that are undertaken. For instance, the delays experienced in zoning 'greenfield' developments has recently encouraged developers to consider the development of existing sites or 'brownfield' developments, particularly in inner-city areas. To some degree, developers' access to market information, financial institutions and professional consultants will influence what site is developed, how and by whom it is developed. Developers who are well established in a market will tend to have access to information not available to newcomers, and can thereby create a competitive advantage, if not a barrier to market entry. The highest and best use of a site is therefore not only determined by market forces but is also closely associated with the players in the market and the institutions that delineate these markets.

Placing an emphasis on the role that institutions play in the market also provides a useful framework within which to explain land usage in South Africa. Harrison (2003) argues that "despite a clear commitment to urban integration and co-ordination, development, housing policies and practices are producing, as an unintended effect, results that are not entirely dissimilar to those produced under apartheid". It can be argued that policies fail to achieve their intended objectives because of the inability or failure of governments to influence or change the institutions and rules of the game that define the operation of markets and their outcomes.

In conclusion, the property market operates in four well defined market segments – the space, capital, development and land markets. The different sectors of the property market also compete against each for land, resulting in a specific urban form. These markets, however, function within a policy and regulatory environment, and within a socio-economic environment which is subject to constant change. The property market continuously reacts to this changing environment, which then results in specific market outcomes. The next section considers the mechanism that connects the different segments of the market, and is followed by an analysis of the players that operate in these markets.

1.4. THE INSTITUTIONAL ENVIRONMENT

In attempting to understand the mechanics of the property market and to interpret property market outcomes, it is important to understand the rules and relationships that generate these outcomes. The market is a network of rules, conventions and relationships that collectively represent the system through which property is used and traded. Actual market outcomes result from the choices made by specific market actors. These can be individuals, companies, government and other bodies.

While some of the rules or institutional arrangements are applicable to the overall property market, some will be relevant to specific components of the market – namely the space, capital, developmental and land segments. As an example, constitutionally determined property rights (or the lack thereof) will impact directly on decision-making in all four segments, while banking legislation or the National Credit Act will have a more direct impact on the capital segment and will only have indirect implications for the other segments of the property market.

The property market institutional framework has three components as illustrated below:

The institutional environment • Political institutions • Social institutions • Economic institutions • Legal institutions		Impetus for development Constraints on development Subject to modification in response to development experience
The property market as an institution • Market (and non-market aspects) • Decentralised and informal • Legal and conventional aspects of property rights • Legal and conventional aspects of land use and developments		Mediator/facilitator of development activity Source of property market information Property market constraints on development Subject to modification in response to development experience
Property market organisation • Users • Investors • Specialist developers • Constructors • Property service providers • Financial service providers • Professional bodies • Governmental and non-governmental agencies		Organisational structure of development Assignment of roles to actors Response to market environment Constraints/enabler of development Subject to modification in response to development experience.

Table 1: The institutional hierarchy of property development

Source: Michael Ball Markets & Institutions in Real Estate & Construction 2006

At the highest macro-level the property market operates within an institutional framework defined by political, social, economic and legal rules through which society is organised and markets operate. This level includes constitutionally entrenched property rights, legislative parameters which give effect to policy, and institutions such as the Competition Commission.

At the next level, the property market is itself considered as an institution with a range of characteristics, rules and customs defining the nature of its particular ‘game’. This market-specific institutional framework determines the structure of the property market and the scope and function of players in the market. Each of the four identified segments will, at this level, have its specific formal and informal rules and regulations. The space segment will, for instance, be influenced by relationships that exist between property owners and broking professionals. The development segment is similarly organised in formal and informal ways.

The operation of the institutional framework is as much determined by formal and informal rules, conventions and relationships. The relationship that exists between different players in the property market, such as developers, banks and investors, will influence how these players interact with each other and which development and investment opportunities are recognised, implemented and coordinated (Ball, 2002). In this regard, neoclassical economics, by paying insufficient attention to the institutional characteristics of markets, assumes that finance will be available to all players at the market rate, and that other constraints such as information barriers do not have a role to play in determining how the market works for different players. Clearly, in the real world, these issues have an important bearing on the efficacy of markets, which serves to emphasise the importance of both the informal and formal rules of the game being policed and enforced, whether through the due process of law or through organisational sanction by the market players themselves.

The third level of the institutional framework comprises the organisations that operate in the property market – buyers, sellers, developers, brokers, municipalities, NGOs etc. The relationship between institutions and organisations at each level, and between levels, can best be described as highly interactive and capable of change in response to action, experience and perceptions of risk and return.

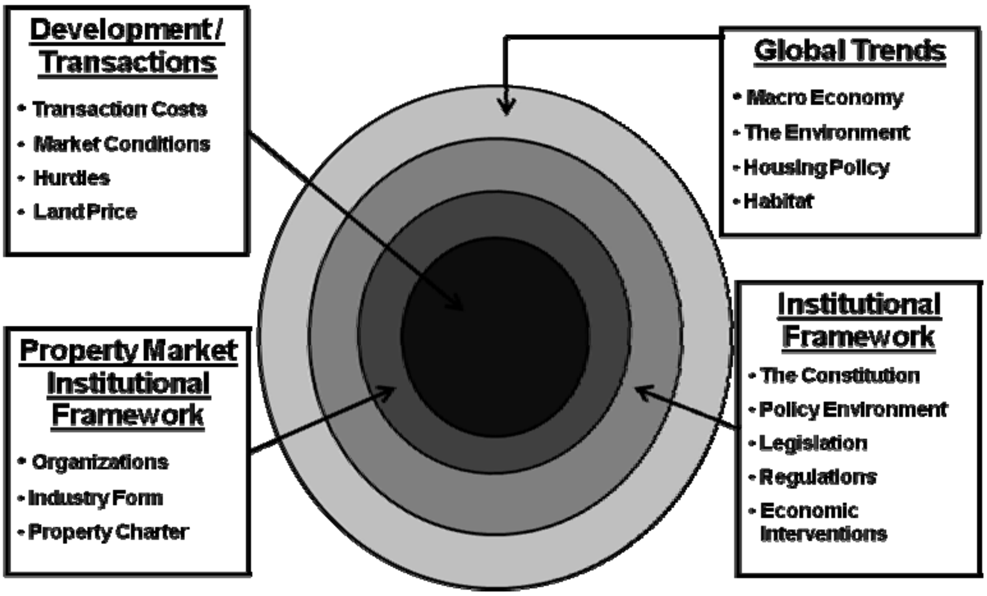


Figure 9: Institutional environment

Source: Viruly

The critical observation is that through the strong linkages that exist between the different segments in the property sector, market outcomes will be a reflection of existing or changing institutional arrangements, whether at the macro-level or at the level of property market institutions and organisations themselves. Thus, through the interaction of its various institutions and organisations at a formal and informal level, and through intricate cause-effect linkages that prevail between its various segments, developments in any segment of the property market, whether internally or externally induced, result in particular – and frequently predictable - outcomes which ultimately manifest in the spatial form of the property market.

For policy makers, a clear understanding of existing institutional arrangements in the property market and an understanding of how the property market and its various segments work is therefore essential. This will help to ensure that interventions are appropriately understood and designed and, once implemented, that they meet their expected objectives. Interventions which are not founded on an understanding of how the market works risk failure or unintended consequences, and ultimately can undermine the institutions and the rules of the game on which markets depend for their effective operation. The demand and supply framework as represented within the four-quadrant model is thus an important policy-analytical tool and an appropriate point of reference for property market planners in analysing their options and designing their strategies.

From a policy perspective, the most important question that arises is how far government intervention has a role to play in improving the efficacy of the market and its economic and social outcomes. The problem faced by government therefore lies both in determining the nature and scale of its ‘guiding’ interventions in a particular market, and in assessing their impact on market institutions and the rules of the game. Achieving the right balance will in large measure depend on the extent to which assumptions about the efficacy of the market, its institutions and the rules of the game hold in practice. Where there are obvious distortions in the arrangements needed to underpin or enforce a competitively functioning market, the case for government intervention to change the institutional framework and amend the rules of the game is clear-cut.

1.5. BEHAVIOURAL DIMENSIONS OF MARKET PERFORMANCE

Property development cycles exist at both the macro and micro levels and are generally influenced by international, national and regional economic fluctuations. These include the general business cycle, inflation cycles, currency cycles, population and employment cycles. By contrast, micro-economic cycles focus on the property market at a city or metropolitan level, including the different segments of the property market, and include urban cycles, neighbourhood cycles, property life cycles, ownership life cycles and capitalisation cycles.

Although property cycles have been explained in a number of ways there is a general acceptance that short-term lags in information flows and decision-making regularly result in a mismatch between demand and supply, which in turn causes property prices to rise and decline. One explanation of property cycles is based on the view that developers find it difficult to forecast the future and often supply the market after demand has peaked, resulting in a market over-supply. In contrast, when the real estate market is tight, developers are unable to respond quickly enough to increased space demand, which results in low vacancies and a higher rental growth than would have been the case in a rapidly adjusting market. Moreover, the length of such lags will vary between markets. For example, although it may take years to develop a large office block, the development of an industrial or residential unit may take no more than a couple of months.

A second explanation focuses on lender behaviour and suggests that as long as macro-economic conditions are conducive and ‘easy’ financing is available, developers will continue to invest and develop. However, the availability of financing is strongly reversed when, for whatever reason, the banking sector experiences a high level of bad loans or the affordability of debt declines. Under this explanation, property cycles result from the tendency of the banking sector to be over–optimistic during the upward phase of the property cycle and overly pessimistic in the downward phase of the cycle.

Other behavioural explanations focus for instance on the reluctance of owners to adjust occupancy and rent levels when demand changes. Research suggests that such behaviour is rational considering the flawed information forecasting techniques that the market has at its disposal, the inherent uncertainty of demand, and the long planning and development processes that exist before new supply reaches the market.

Whatever the precise behavioural components of property market cycles, from a general perspective, it is clear that behavioural considerations have an important influence on the pattern of market performance. Property investors typically ignore the reality of property cycles during the expansion phase of the property market because high profits, commissions and financing fees are being made. In these circumstances, it is in no-one’s interest to suggest that the boom could come to an end. Because of such behavioural factors, the upward phase of the property cycle often leads to an overpricing of assets, while the downward phase of the market cycle goes down faster and further than is expected or warranted in terms of market fundamentals, resulting in the under-pricing of assets.

Behavioural economists (Stocken, 1993) suggest that players in the economic arena are psychological beings, conditioned by their immediate past experiences. Because of the way information is interpreted by market players, cycles are created, and these are exacerbated by the short-term nature of players’ memories and horizons. Stocken (1993: 83-84) thus suggests that:

“Following an extended period of prosperity, men and women adopt the psychology of affluence and its by-product, economic optimism, wherein they enjoy life, have fun, and become risk takers. This mass psychology of optimism, once set off, takes on a life of its own and continues until people become excessively optimistic. They rationalize that what has happened will continue to happen, and thus come to see less risk than actually exists. Consequently, too many people become risk-takers, which in turn creates the conditions for a big bust. This bust, or depression, then sets off a psychology of pessimism which continues until people eventually see less risk than really exists." This in turn then creates the basis for an upturn and an ensuing period of economic expansion.

The trajectory of the property market is therefore fundamentally affected by the way players *perceive* conditions in the property market and how they interpret and respond to opportunities and constraints presented to them.

1.6. MARKET PLAYERS

1.6.1. INTRODUCTION

As defined earlier, the South African property market can be divided into four main segments – namely the user market segment, the financial market segment, as well as the development and land market segments. These market segments have specific players which are connected in a manner that reflects the socio-political framework (the rules of the game) in which the property market operates.

Theoretically, the network of players in the South African property market can be explained in different ways. One of these refers to sequencing models which attempt to characterise a market by explaining the steps that exist for a transaction to occur successfully. Under this approach, a property transaction is divided into its numerous components such as information gathering, negotiation, valuation and the contractual closure of the transaction. Alternatively, 'agency' or 'institutional' models of analysis emphasise the organisations found in a market, and highlight the determinant impact of the roles, behaviour and decisions taken by these organisations. This approach also emphasises the important relationship between the socio-political rules that drive the market and the players in it. Accordingly, a property transaction is seen as an interaction between different players/organisations with specific roles and objectives.

Conventional economic analysis is often accused of neglecting the social/institutional rules and players that influence markets. Economic theory largely explains market form through an approach that places an emphasis on the minimisation of transactions costs. The principle behind this is that efficient markets create organisations, and networks between such organisations, that minimise transactions costs. For instance, the focus on cost minimisation and the avoidance of risk has resulted in the property development function becoming an intricate network of independent professionals, coordinated by a project manager. It would not be economical from an organisational perspective to have the services of these different professionals retained in-house.

The organisations and networks that define the South African property market have developed over time - reflecting a changing institutional environment. For instance, until a few years ago very few developers would have considered securing the services of an environmental consultant. However, changing regulations in the environmental and property development sector have required environmental consultants to play a greater role in the development process.

As illustrated in Table 1, a hierarchy exists in the property institutional environment (defined earlier). At the highest level, the property market is influenced by political, social and economic institutions. These institutions influence the formal and informal rules that drive property transactions. At the second level, one finds the formal and informal institutional characteristics of the property market. This includes legal and conventional aspects of property rights, and the rules of property transactions developed in the property market itself. At the third tier one finds the organisations or players that make up the property market. Invariably these different tiers influence each other through a feedback mechanism.

The argument is often made that, since the property market reflects specific arrangements between market players, it therefore should not be seen as a neutral arbitrator. This leads to the conclusion that appropriate policy and other changes to the rules that characterise the property market can influence market outcomes. This is entirely true, although, as will be seen subsequently, the nature and extent of such changes will have a direct bearing on the operation of the market, its efficacy and impact. (Ball 2006)

The following analysis identifies the major players in the South African commercial and residential property markets and attempts to identify the linkages between them.

1.6.2. IDENTIFYING LINKAGES IN THE SOUTH AFRICAN PROPERTY MARKET

The major organisations in the South African property market include developers, the banking sector, government, property owners, tenants, investors and property professionals. The players will vary somewhat from one market segment to the next. For example, retail developments require specific expertise that is not required in other commercial developments. Brokers in the residential market will rarely operate in the commercial property sector as well. And government is both a player in the market and the arbitrator of the rules that govern the market.

Here one must refer once again to Table 1, which illustrates the major players in the South African property market and the linkages between them. This table reflects the complexity of the property market and the numerous players involved, and once again shows the interconnected nature of this market. It should be viewed in conjunction with the four-quadrant model outlined earlier, which depicts the manner in which the property market works, and the inter-relationship between its spatial, capital, development and land segments.

As an example, the developer will normally be linked through a sales/option agreement with land owners. The funding of a development project will be secured through a short-term financing arrangement with the banking sector. The banking sector in turn influences which developments will and will not be financed. To be initiated, the development process requires the signature of construction and other contracts.

Added to this, the developer will rely on professionals such as town planners, architects and valuers. The completed project will be sold to an investor through a broker or another investor or owner. The investor (buyer) will fund the investment through a mortgage bond. The investor may also wish to lease the property to a tenant, a function often facilitated by a broker. Finally, the overall development process will take place within certain public sector constraints, such as town planning, building and environmental regulations. The often strong connections between developers, investors and financiers do influence the type of opportunities that are considered.

Similarly, property transactions occur through an impressive network of players. Investors are normally linked through a broker. The transaction will also be facilitated by numerous professionals such as conveyancers and valuers.

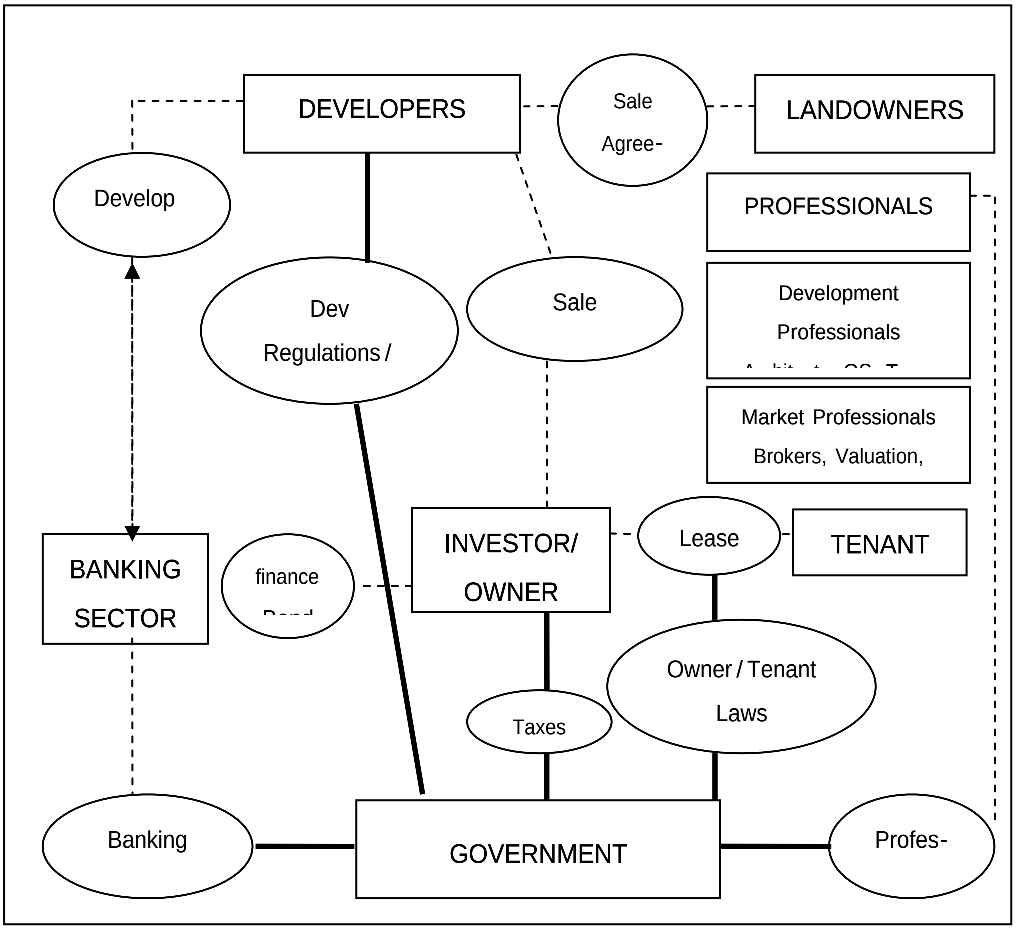


Figure 10: The players in the property sector

Source: Viruly Consulting

1.6.3. THE PLAYERS

THE DEVELOPMENT MARKET

Property developers play a critical role in the South African property market, as they assemble land, and raise the capital in order to develop the property. Development activity is constrained, as we will see, by town planning, environmental and other legislation. This will influence what can be developed and how developments will be undertaken.

Moreover, urban development is a complex process which entails the orchestration of finance, materials, labour and expertise, and by many diverse actors within a wider social, economic and political environment.

As we have seen, the decision to develop or not will be influenced by the demand for the type of property, land availability, as well as expected returns that could be generated from the property. The development process has certain clearly defined phases which include the identification of land, the generation of the development concept, the building phase and the marketing phase. The development process can also be characterised as a coordination effort between different players. These include architects, town planners, banks, property brokers and investors. Although large property developers will have some of these functions in-house, the development process normally requires the coordination of activities outside of the development company.

Development activity is strongly reliant on the availability of short-term development/ project financing. While it is difficult to highlight the numerous issues that influence financing decisions, some of the most important factors would include market conditions, the locational risk of a development (influenced by issues such as urban regeneration and incentives) and the experience of the developer.

The development process is normally considered a relatively high-risk activity. The risks lie in numerous spheres. These largely include political and market risk. Political risk includes the risk associated with town planning activity, the certainty of receiving the required infrastructure, the stability of institutional arrangements and the enforcement of the rules of the game. Market risk is associated with whether expected sales will happen at the forecast values. The general shortage in the supply of properties, especially in the residential sector, means that market risk is usually less significant.

THE BANKING SECTOR

As most property transactions require some level of debt financing, the banking sector has a critical role to play in determining issues such as:

- What type of developments will occur
- Where developments will occur
- Who receives the financing
- The level of development/ transaction activity that will occur.

Generally, property-related financing can be divided into two spheres of activity. The first is long-term investment funding and the second relates to short-term project financing.

Investment financing is offered to investors in the commercial and residential property sectors. This type of financing will be of a long-term nature (10 to 15 years) with risk being relatively limited. The lending decision will be influenced by the collateral or security that can be provided, as well as the ability of the investor to service the loan. The collateral value of the bonded property will be assessed through a valuation exercise which will be a function of expected market conditions and views regarding conditions in the node in which the property is located. The ability of an investor to service a bond will be influenced by the income of the bond holder. More recently, the provisions of the National Credit Act have played a role in determining whether a potential bond holder can service the debt in question.

The second sphere of banking interaction in the market is focused on development activity. Lending in this segment of the market is normally considered to be higher risk than long-term financing in the investment market. The financier will, as discussed earlier, be influenced by the type of development under consideration, its location and the expertise of the developer.

With debt financing being an essential component of the property market, the banking institutions have a central role to play in shaping the outcomes of this market. As such, the banking sector has an important role to play in determining the overall micro and macro-direction of the property market. At a micro level the banking sector influences where developments will occur and where the users of space will be situated. At a macro level, the banking sector, through its lending decisions and its collective appetite for risk at any particular point, has a role to play in determining upward and downward swings in the property cycle. Various studies have suggested that the banking sector tends to be overly willing to lend during the upper phase of the property cycle (when confidence is typically high), whilst being overly negative during the down-swing of the property market – thereby aggravating the cyclical nature of the market.

INVESTORS

Investors in the South African property market vary from the owners of single residential properties to those who own portfolios valued at several billion Rands. Investors across this investment spectrum face similar problems. These are associated with the characteristics of property investments and will vary, depending on the size of these investments, the availability of information and the particular gearing (i.e. the combination of debt and own capital) associated with specific property opportunities and investments.

Investors hold properties in several different ways; these include:

- Freehold ownership
- Leasehold
- Property companies
- Shareblock companies
- Syndications
- Sectional title ownership
- Property unit trusts
- Property loan stocks

Although most investors seek a combination of capital growth and income yield, the emphasis placed on these components will vary significantly between investors, depending on their circumstances. Property cash-flow risks include business risk, financial risk and socio-political risk. Business risk is largely associated with the risk that the property becomes structurally, financially or economically obsolete.

Property investors are linked with other players in the property market through well developed market and transactional linkages. The investor relies on brokers who play the role of introducing retail buyers to sellers. As discussed, the investment transaction may also include the services of property valuers, commercial banks and conveyancers.

THE TENANT

The tenant, or occupier of space, is largely responsible for generating the income (through rental payments) of a property investment. In both the commercial and residential property sectors, tenants rely on brokers to introduce properties.

The user of space has a tenure choice – they (households and businesses) can either rent or own. The decision depends on numerous factors. For the household, the tenure choice will be influenced by income, household composition and distance to place of work. For the commercial tenant, determining factors include occupational flexibility, capital requirements associated with ownership, and whether capital is best allocated to real estate or other opportunities. Perceptions of risk will inform the views and circumstances of (prospective) tenants across all sectors.

THE PUBLIC SECTOR

The public sector formulates the rules and regulations that dictate how the property market operates. This institutional framework is influenced by the Constitution, acts, policies and regulations, and the extent of their enforcement at the different tiers of government.

Apart from influencing the rules of the game in which the property market functions, the public sector is also a player in the market. At national government level, government owns properties estimated at well over R 250 bn. In addition government owns land available for development. At local government level, government may interact in the property market through a variety of property entities, such as the Johannesburg Housing Company and the Johannesburg Property Company (JPC).

Through its dual role as the formulator of policy and actor in the property market, government has significant opportunities to influence players and outcomes in the property sector. Most importantly, it defines the rules of the game in which the property market functions. Depending on how these functions are conceived, applied and enforced, they will enhance or detract from the effective operation of the market.

PROPERTY PROFESSIONALS

Property professionals can largely be divided into two categories. The first category includes town planners, quantity surveyors and architects. This category is primarily involved with the development process. A second category, which includes brokers, property management and asset management, is primarily concerned with the facilitation of the property investments, and the management of these assets.

Property professionals exist because they provide an important and cost effective link between role players in the property market. This often means providing a conduit of market information and specific expertise. While larger financial institutions and developers may from time to time in-source such professional services, the normal approach has been to contract these parties as and when required.

1.6.4. CONCLUSIONS

The South African property market is characterised by a complicated and extensive network of players. This network has developed over decades, reflecting a changing socio-political environment. The market network has both formal and informal components. The formal components reflect contractual arrangements between different parties. Informal linkages are somewhat more difficult to identify and will normally reflect the rules that exist within a community or profession.

The existence of certain players in the property market, as well as the networks that underpin them (all of which change over time), will be influenced by the socio-political environment in which the market functions.

As outlined earlier, changes in the institutional environment or the rules of the game will directly influence market structure, interactions between the players and ultimately market outcomes.

2. AN UNDERSTANDING OF THE URBAN LAND MARKET IN SOUTH AFRICA

2.1. THE SIZE AND CHARACTERISTICS OF THE SOUTH AFRICAN PROPERTY MARKET

As discussed in section 1.3 of the report, the dynamics of the South African property market can be explained in terms of the inter-relationship between the space, capital, developmental and land segments. The following sections highlight conditions in these markets and the linkages between them.

The size of a real estate (space) market is largely determined by demographic factors and the economic base of the market. This can be expressed in a number of ways. In South Africa this relationship can be illustrated by comparing the economic size of the largest metropolitan areas against the size of their office markets. Although a correlation does exist, Table 2 below illustrates that this will be informed by variations in the economic structure of each area. Thus in Johannesburg the amount of office space compared to the size of the economy is relatively high, reflecting the relative dominance of the service sector in Johannesburg. This can be compared with other Metros such as eThekwini, which has a local economy based more on manufacturing, and hence has less need for office space.

Correlation of Office Stock and Economic Output (Gross Value Added)			
Municipality	**GVA total 2004 (R)**	**A & B Grade m^2 2006**	**GVA / m^2 (R)**
Johannesburg	221,376,293	6,329,535	34.97
Cape Town	137,148,900	1,512,204	90.69
eThekwini	122,116,536	609,358	200.40
Tshwane	112,293,409	1,585,393	70.83

Table 2: Gross value added (GVA) per major metropolitan area and size of A & B property markets in these areas

Source: SAPOA & South African Cities Network 2006

The dynamics of the SA property market are not determined by its size, but rather by the determinants of its growth and that of its individual sub-sectors, along with their locational drivers.

An analysis of demand and supply in the property market can be divided into two broad markets, namely the market for *existing* space and the market for *new* space determined in the development market. The market for new space in a particular year will normally only be a small proportion of the total existing supply.

The market for existing space comprises stock built in the past and will normally reflect market conditions at different points in time. Thus, one should expect that some of the existing supply will be obsolete from a market perspective. This is evident in numerous CBDs that comprise an office stock that no longer meets market requirements, and so stand empty.

The obsolescence of space is caused by a number of factors. These include physical, economic and functional obsolescence. When the demand for a site or property declines because of physical obsolescence, it is normally because the property no longer offers the physical attributes required by the market. The poor maintenance of a building would be an example. A building or site that is physically in good condition may nevertheless suffer from *functional* obsolescence because it no longer offers the amenities that the market requires. Such amenities may include parking facilities, access to information technology or an appropriate lifestyle. A site or property suffers from *economic* obsolescence when rentals or values in an area have declined to such a degree that investors and developers abandon a property.

Property market economics suggest that with time, a property that no longer reflects investor objectives will be demolished or converted, and will make way for new developments. This is a normal feature of any dynamic property market. In South Africa, commercial properties situated in CBDs are either being renovated or demolished to reflect changing market conditions. Certain office buildings are put to a new use and are converted into residential units. These trends will be enhanced or hindered by circumstantial factors (perceptions of crime, grime etc, as well as targeted incentives).

As discussed in section 1, the logic of the market suggests that, with time, urban land will always, from an economic perspective, be converted to its highest and best use. If, in the short term, an alternate use is not found, a site may remain vacant or be used below its optimal use. As has been illustrated in many cities across the world, appropriate public sector urban regeneration initiatives and incentives can play a role in ensuring that properties and sites suffering from some level of obsolescence are revitalised and brought back into the market in an appropriate use.

The second component of supply in the property market comprises new supply which developers bring to the market. Developers assess present market trends in the residential and commercial property space markets and identify sites and properties that can be developed profitably. This entails balancing development costs such as land, materials and labour against the value of the proposed project in its intended use. The decision to go ahead with a development will also be influenced by conditions in the capital markets and existing institutional constraints and opportunities.

New supply in the development segment of the market takes place through what is often referred to as the 'supply pipeline'. This pipeline is constructed to reflect the quantity of space that will come onto the market over time. Thus at the end of the pipeline is the space which is currently entering the market. Next is the space under construction. Before this is land with planning permission. Finally, at the start of the development pipeline is land for which planning permission is being sought.

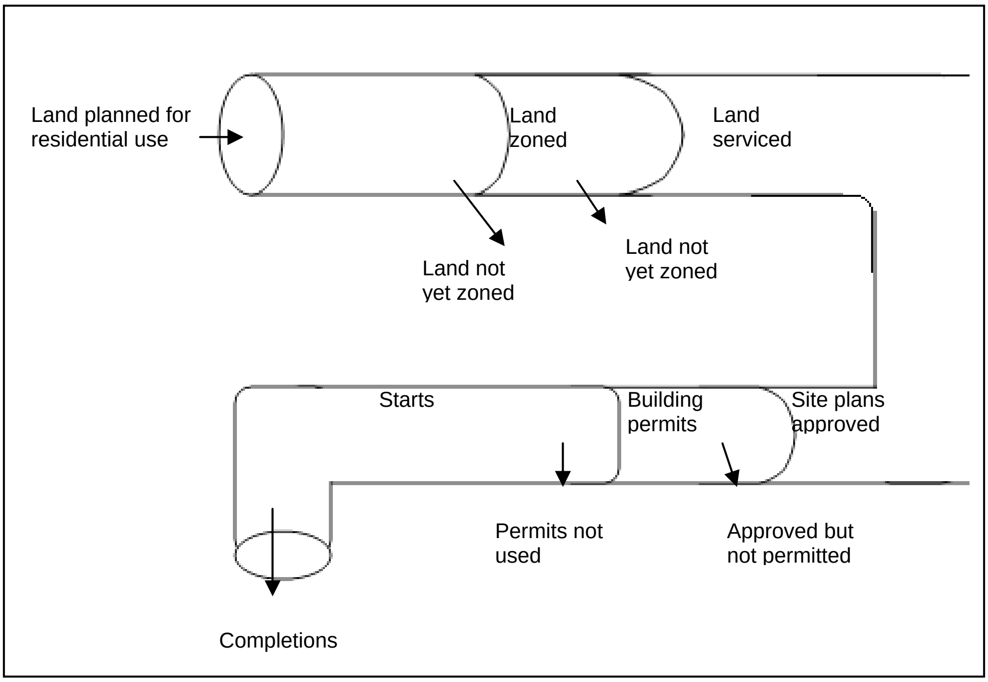


Figure 11: Pipeline analysis

Source: Carn et al (1988)

An impression of residential and non–residential stock entering the market can be gained by turning to national gross domestic fixed investment figures for the South African property market. Total investment by the residential and non-residential sectors amounted to R 69,2 billion in nominal terms in 2006, with the residential and non-residential sectors responsible for roughly equal shares. The trend for sectors over the last five years is illustrated in Table 3.

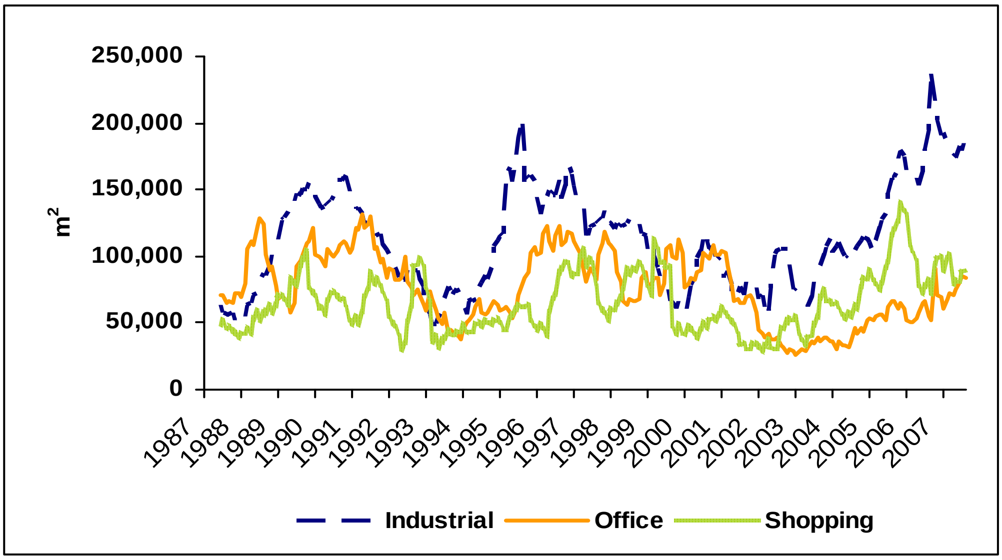
Year	Residential	Non Residential	Total Buildings	Real Growth Total Building %
2000	13,202	16,197	29,399	10.2
2001	14,035	16,996	31,031	5.6
2002	14,963	15,575	30,538	-1.6
2003	16,444	16,265	32,709	7.1
2004	18,188	17,965	36,153	10.5
2005	21,703	19,233	40,936	13.2
2006	23,643	21,546	45,189	10.4

Table 3: Construction activity (constant 2000 prices in millions)

Source: SARB

The value of recorded building plans passed (properties in the pipeline) by the larger municipalities for 2006 was R75.4 billion. Residential building plans passed contributed the most to the total value of building plans passed (54.7%) followed by additions and alterations (25.7%) and non-residential buildings (19.6%).

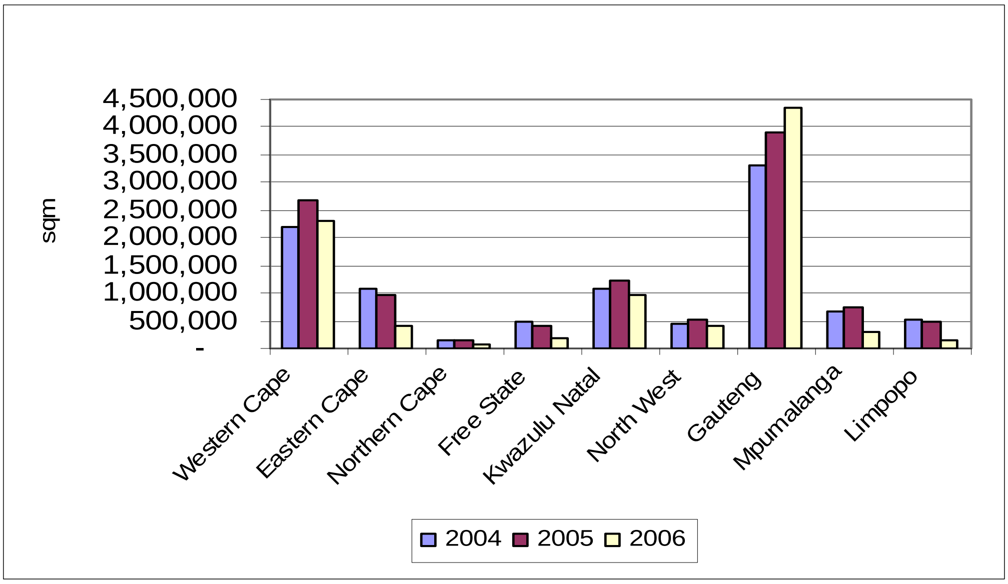
The pipeline can also be depicted, and its vitality tracked, in terms of building plans passed. The trend in the commercial property market building plans passed is illustrated in Graph 6. This again illustrates the cyclical nature of the property market and the fact that the effect of rising interest rates from 2007 probably implies that the peak of the current cycle has been reached.



Graph 6: Building plans passed

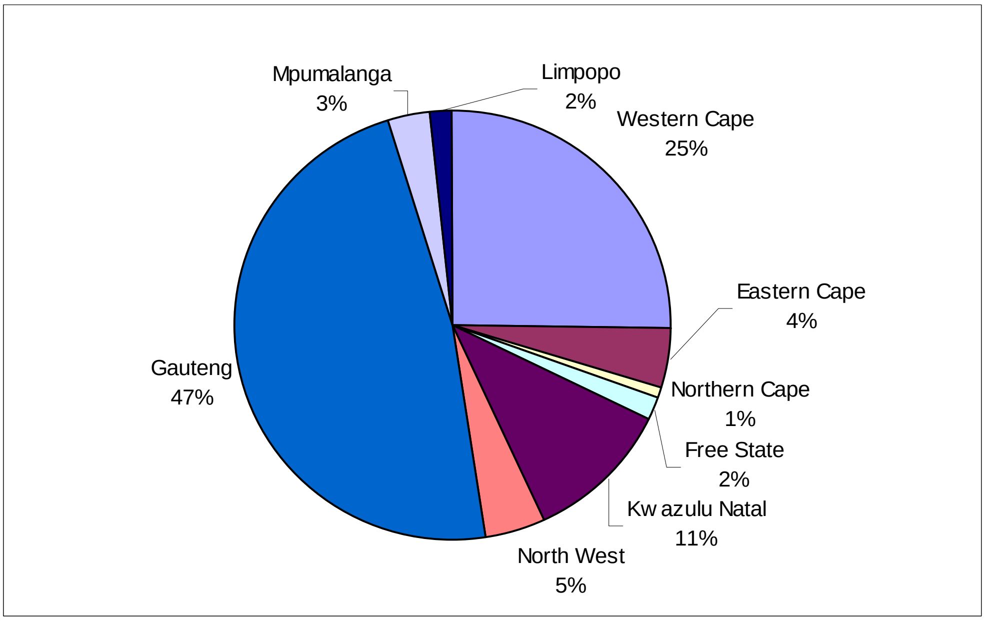
Source: Stats SA

In understanding new supply entering the market, it is also of interest to break building activity down on a provincial basis. This again illustrates that total building plans passed (commercial and residential) is dominated by Gauteng, the Western Cape and KwaZulu-Natal – which is also largely reflective of the economic contribution of these provinces to the national economy.



Graph 7: Buildings plans completed

Source: StatsSA



Graph 7: Provincial distribution, total building plans completed

Source: StatsSA

The following table also shows the correlation between SA's provincial demographic profile and residential building plans. It illustrates that residential building activity and province population size are not necessarily correlated; the correlation depends on the strength of economic activity.

Province	Population (Census 2001)	% of Population	SQM Completed, 2006	% of SQM	% of GDP 2006
Western Cape	4,524,335	10.09	2,323,960	25.34	14.8
Eastern Cape	6,436,763	14.36	405,361	4.42	7.8
Northern Cape	822,727	1.84	64,781	0.71	2.2
Free State	2,706,775	6.04	169,603	1.85	5.4
KwaZulu Natal	9,426,017	21.03	981,748	10.71	16.3
North West	3,669,349	8.19	421,759	4.60	6.4
Gauteng	8,837,178	19.72	4,360,001	47.54	33.6
Mpumalanga	3,122,990	6.97	288,031	3.14	6.8
Limpopo	5,273,642	11.77	155,109	1.69	6.8
Total	**44,819,776**	**100.00**	**9,170,353**	**100.00**	**100.00**

Table 4: Residential building plans completed

Source: Stats SA

Supply in a metropolitan area will be a reflection of urban growth, which takes three main forms. First, there are opportunities that arise from urban renewal. Second, the property market grows in a particular area because of the specific market opportunities it offers. Third, demand arises as a result of economic growth and development.

At a macro level therefore, economic and demographic factors combine to influence building supply in the South African property market. These macro trends manifest themselves separately in terms of conditions in the space market (where locational decisions are made), the financial or capital market (where properties are acquired), the development market (which provides) and the land market. The outcome of the interaction between these market segments results in the spatial form and the overall dynamic of the property market.

2.2. SPATIAL PATTERNS

Mapping data commissioned for this study used data from the national deeds registry to show the spatial patterns of South African cities. This data showed that the *distribution* of property values over the past 15 years has not changed significantly, at least at the level of aggregation possible with this dataset. As the analysis in section

2.4 will show, when the underlying data were interrogated, interesting findings emerged which were not evident in the maps. Figure 12 below shows the median house prices in Johannesburg, coloured from red (most valuable) to blue (least valuable). This comparison over time can provide a visual indication of which suburbs are relatively more expensive. For example, in the map below the high property prices in Johannesburg's northern suburbs are clearly distinguishable, while the relatively low price of property in Soweto is also clearly discernable. Further mapping images are contained in an appendix to this report.

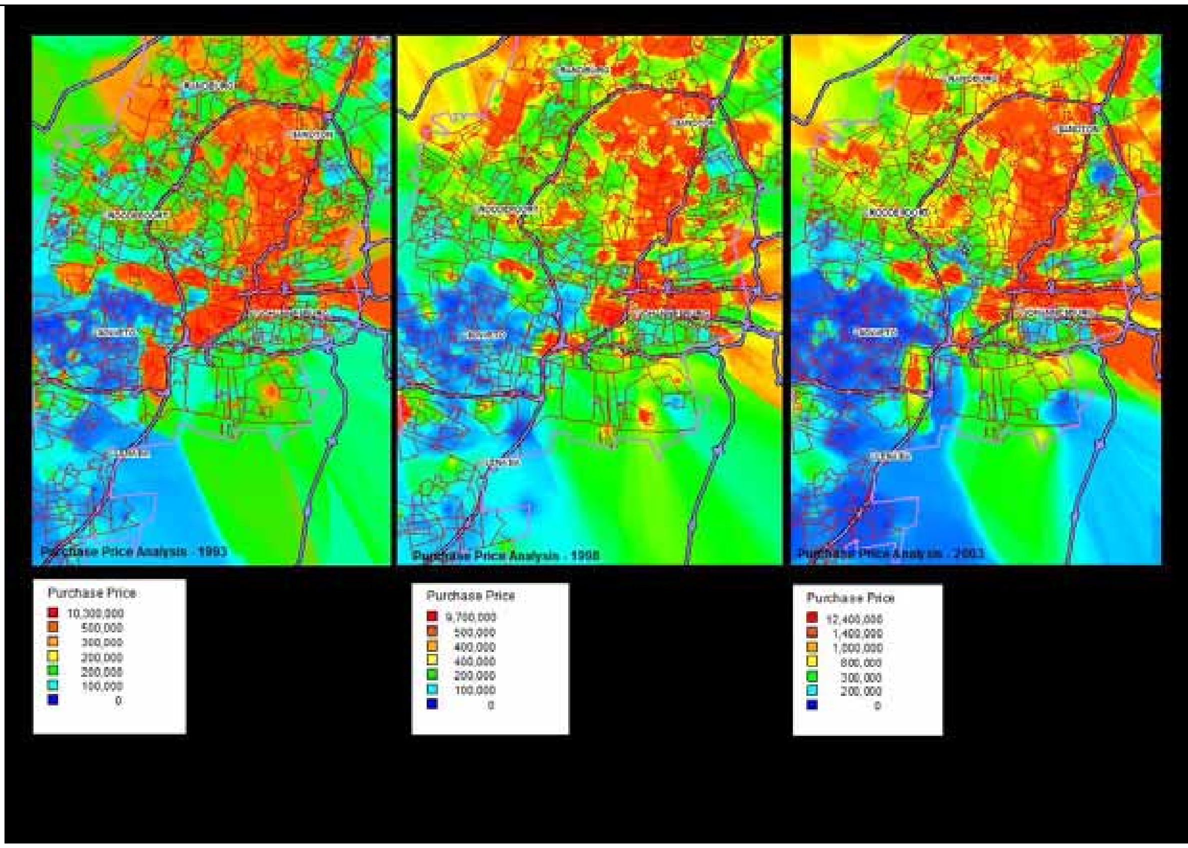


Figure 12: Median purchase prices at 5, 10 and 15-year intervals: Johannesburg

2.3. THE COMMERCIAL PROPERTY SECTOR

The South African property market has seen significant structural changes over time. While in the past commercial properties were largely financed through large pension funds, this has changed in recent years, with the South African debt and equity markets playing a more important role. The level of debt financing secured by listed funds (which include property loan stocks and property unit trusts) has continued to rise, with certain funds operating at a debt / equity ratio of above 50%.

While it is difficult to determine the size of the commercial property market, recent figures produced by the Investment Property Data Bank (IPD) suggest that the listed sector is valued at some R100 billion. Some of the larger players include Growth Point (valued at some R20 billion) and Redefine (valued at R5 billion). It is estimated that other players in the private sector hold commercial properties valued at some R 150 bn. To this should be added properties held by the public sector, estimated at some R250 billion (which include all types of properties). Thus, the institutional quality of the commercial property stock could lie in the region of R300 billion.

In understanding the commercial property market space segment, it needs to be underlined that from the 1960s onwards South African CBDs have been characterised by the decentralisation of the commercial and retail property stock. In 1966, Johannesburg saw the opening of the Killarney Mall – one of the first decentralised commercial shopping malls. Over the next decade, malls opened in Benmore, Hyde Park and Bryanston. This was followed by a further decentralisation of shopping facilities in Bedfordview and Randburg (Beavon 2004).

From a development perspective, shopping facilities in the townships remained under-supplied during most of the 1980s and 1990s, with the total amount of shopping space in Soweto in the early 1980s amounting to 67 000 m², serving some 800 000 million people. By contrast the Mall in Sandton had 38 000 m² of shops, serving a much smaller population. This has recently changed with the development of, among others, the Maponya Mall (60 000 m²) in 2007. This development reflects the socio-economic transformation that has taken place over the past 15 years, as the disposable income of residents of Soweto have increased and investors' risk perceptions have changed, justifying commercial developments of this nature.

Figure 13 illustrates the dispersion of shopping centres in the period 1991 – 2002. The diagram is useful for two reasons: first it shows the dispersal of buying power in the Johannesburg Metropolitan area and secondly, it illustrates the urban sprawl that has characterised a metropolitan area such as Johannesburg.

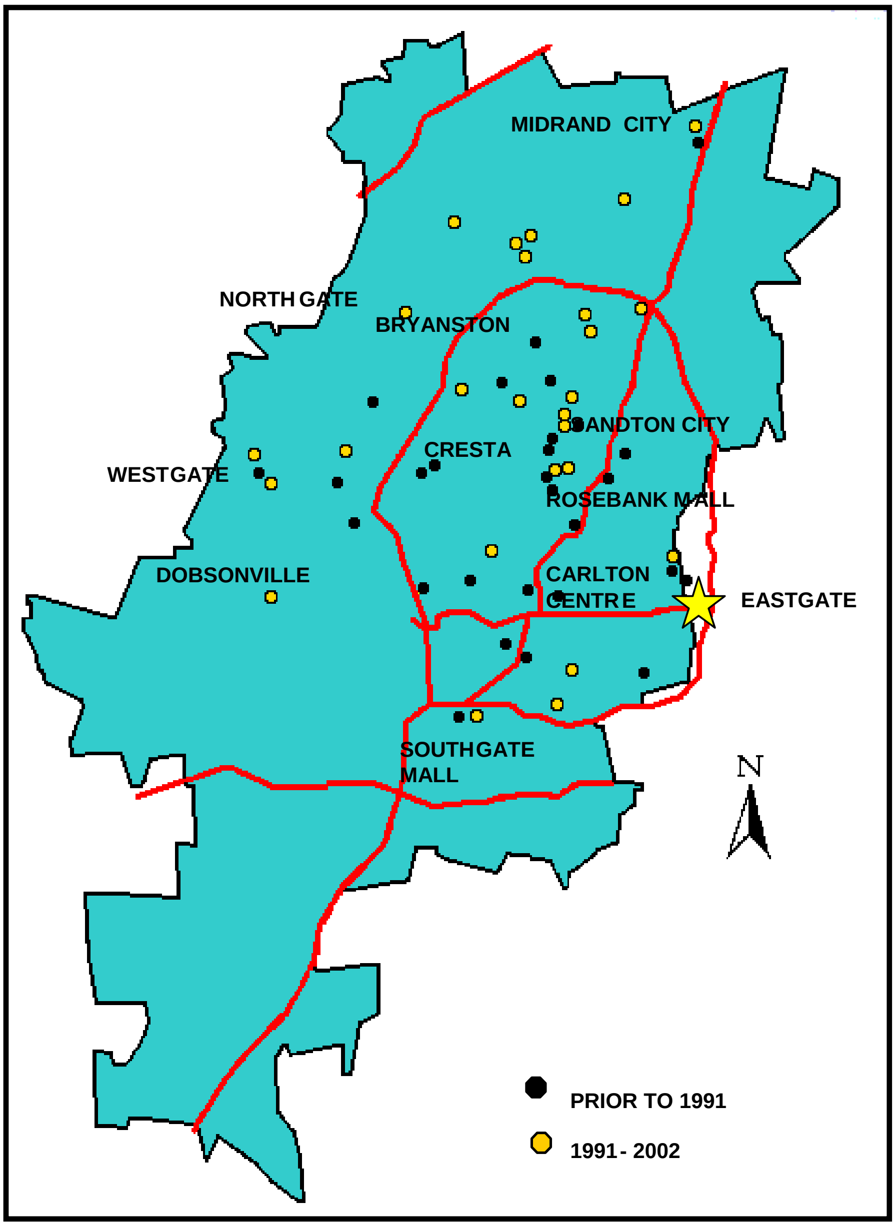


Figure 13: Distribution of shopping malls ≥10 000 m² between 1991 and 2002 in Johannesburg metropolitan area

Source:. Beavon, 2004

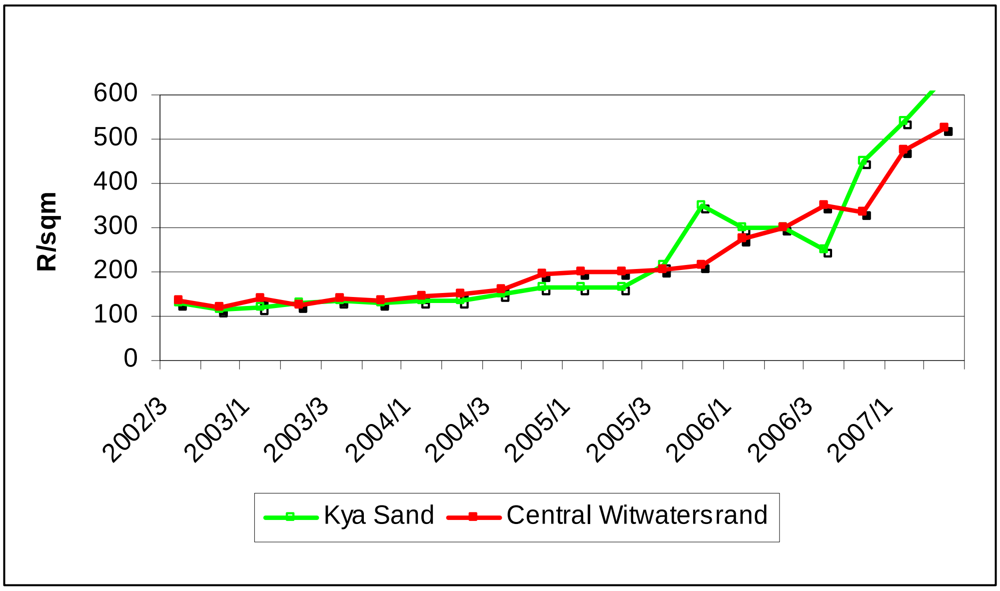
In the late 1980s and 1990s the decentralisation of office space accelerated in most South African metropolitan areas. This saw the rapid development of nodes such as Sandton and Rosebank in Johannesburg, the Berea and Umhlanga in Durban, and Claremont and Rondebosch in Cape Town. The decentralisation of office space was driven by numerous factors, including perceptions of inner-city crime and grime. In addition most inner-city developments could not provide the required level of parking facilities.

In the major metropolitan areas, office-based firms wishing to operate in low-rise office complexes began acquiring relatively cheap land in residential suburbs. The supply of land was also made possible by the fact that many higher-income households had decided to dispose of properties and live in smaller residential units. The development of decentralised office nodes was also driven by locational factors. Companies increasingly wished to move to sites that were closer to shopping facilities and residential nodes. By 1982 it was estimated that there was about 350 000 m^2 of office space in the northern suburbs of Johannesburg, equal to nine percent of the total office space in Johannesburg. The demand for office space increased in the early 1980s, pushing up the rentals that could be charged and encouraging developers to begin building more offices. (Beavon 2004)

Despite the strong decentralisation trend of office space in recent years, the CBDs have continued to be anchored by financial, insurance and mining companies. In Johannesburg, the CBD is anchored by Standard Bank, ABSA Bank, major mining houses, and provincial government departments.

Over the past two decades, the commercial property market has also seen a transformation in the spatial allocation of Industrial space. More recently industrialists have tended to move to well located, secure industrial parks such as Limbro Park in Johannesburg, Montague Gardens and Marconi Beam in Cape Town, and Mahogany Ridge and Mount Edgecombe in Durban. This decentralisation of industrial space has however, resulted in high vacancy rates in older industrial areas located close to the CBDs.

Turning to the land segment of the commercial property market, the shortage of developable land, to some degree caused by the introduction of urban boundaries (which inhibit the conversion of agricultural land to other uses) has resulted in rising urban land values. Graph 8 illustrates the significant rise in industrial land prices since 2006, a direct consequence of land shortage in the face of strong growth.



Graph 8: Land values in the Johannesburg area

Source: Viruly

The future growth of the city will be influenced by the land made available for development, but equally importantly, it will be determined by the availability of infrastructure such as the Gautrain rapid rail link.

From a spatial perspective, smaller South African towns and the former townships in metropolitan areas are seeing significant transformation and are offering renewed opportunities. In particular, certain historically small towns are experiencing the benefits of rising commodity prices (Rustenberg), tourism (Knysna) and a rise in consumption expenditure, *inter alia*, underpinned by social grants. The development of, for instance, the Dube Trade Port and related airport development should also provide an important catalyst for the Durban market.

To gain an understanding of the capital segment of the commercial property market, it is worth turning to data provided by the Investment Property Data Bank (IPD) for the past twelve years. The trend in total returns is illustrated in the following table:

Total Return	‘97	‘’98	‘99	‘00	‘01	‘02	’03	‘’04	‘05	‘06
Retail	23.0	9.1	17.9	10.4	13.4	11.0	17.4	26.1	32.6	27.4
Office	12.8	1.6	9.5	12.7	7.8	5.1	8.5	16.7	25.6	24.5
Industrial	16.8	2.1	8.3	7.1	7.5	8.8	17.5	24.4	33.0	31.1
Other	18.1	5.1	24.9	16.6	10.0	20.5	25.4	27.5	24.7	22.0
Property	17.5	5.1	13.7	11.2	10.6	9.5	15.1	23.4	30.1	26.7

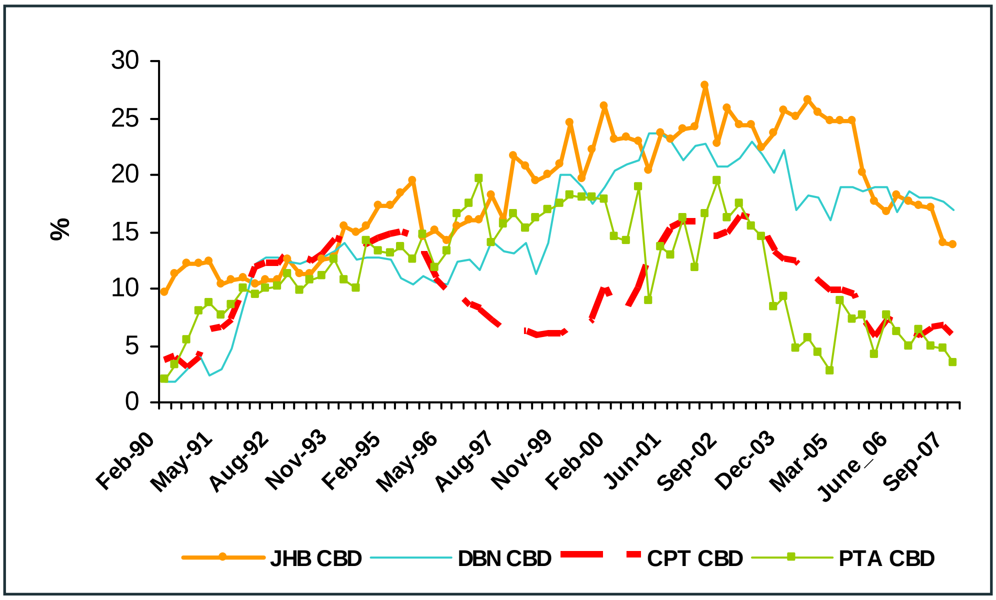
Table 5: Total returns

Source: Investment Property Databank

These figures show the strong performance of the retail sector, which has outperformed the rest of the property market in the past five years. These relatively high returns in the retail sector reflect rising real disposable incomes in a relatively benign inflation environment. Sustained high returns attract investors into the sector and have been a major catalyst for new developments.

The vacancy rates in the office sector (the percentage of empty space as a proportion of total space in the market) across different space nodes, while being relatively similar in the 1980s, now vary considerably. For example, while decentralised nodes are seeing vacancy rates as low as 5%, vacancy rates in CBDs are as high as 15%.

The vacancy rate across different South African CBDs is illustrated in Graph 9.



Graph 9: CBD Office vacancy rates

Source: SAPOA

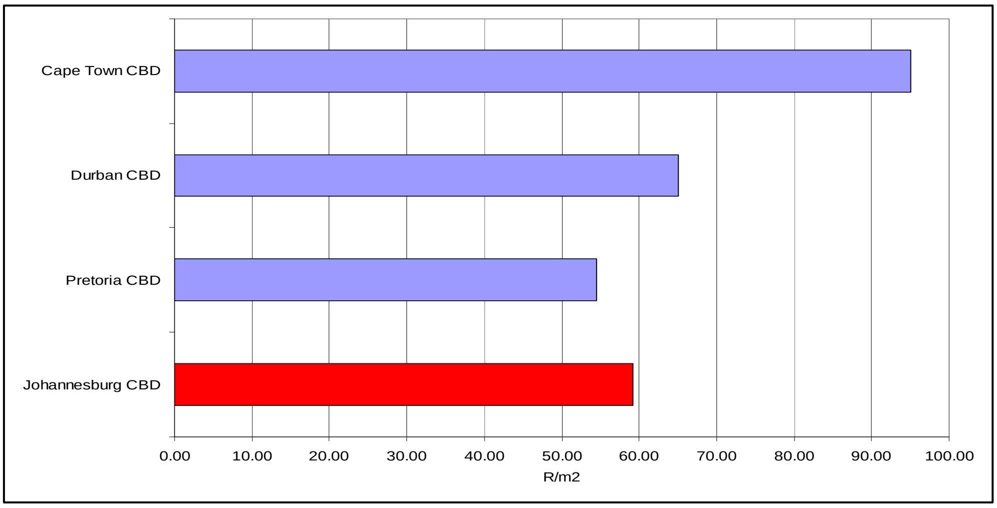
In decentralised nodes away from the historical CBDs, strong demand for space in most suburbs has resulted in a general decline in vacancy rates. This has pushed rentals upwards, which has encouraged developers to enter this sector of the market. Consequently, in decentralised nodes and across the board, vacancy rates have declined to 10-year lows.

Graph 10: Decentralised A & B vacancies

Source: SAPOA

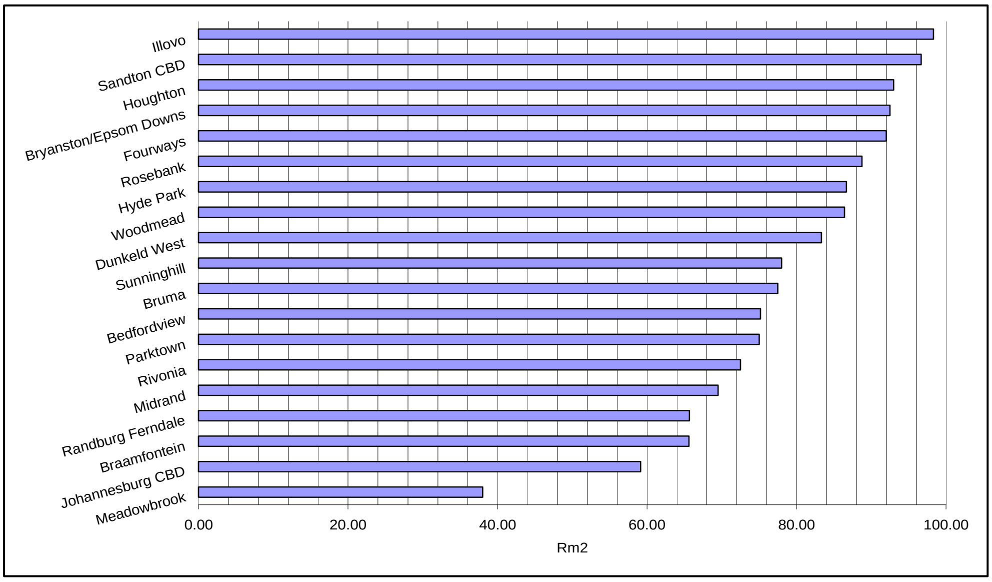
This has presented opportunities for annual rental increases in excess of 20% and, as can be expected, developers are reacting to this with an increase in development activity. Forecasts suggest that the office sector will remain relatively well balanced in the medium term. In line with global trends, the focus is likely to shift towards mixed use developments which offer an appropriate balance between home, work and play.

The variation in vacancy rate trends recorded by the main metropolitan CBDs translates into an inter- and intra-metropolitan rental dispersal as is illustrated in the following graphs. Higher vacancy rates translate into lower rentals, and the variation in these rates simultaneously creates openings for market entrants at various income levels.



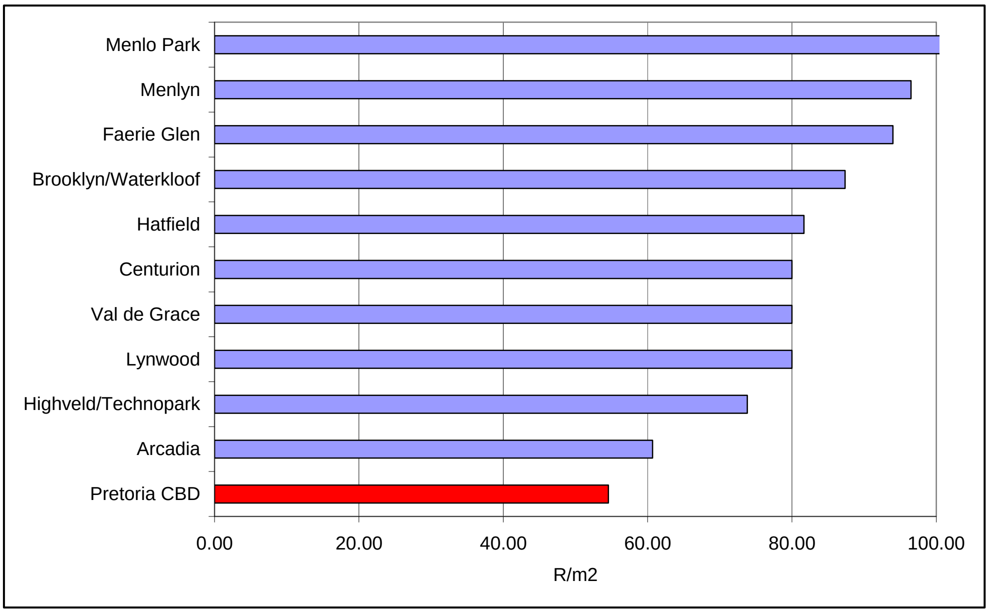
Graph 11: Market rental rates for office buildings in CBDs ("A" Grade)

Source: SAPOA



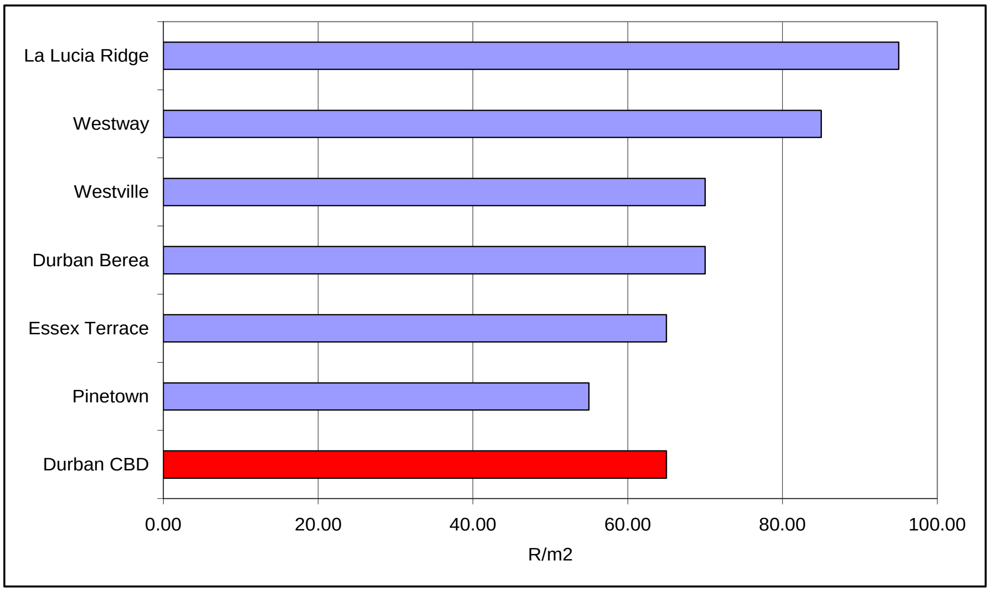
Graph 12: Market rental rates for office buildings (Johannesburg) R/sqm

Source: Rode 2007;3



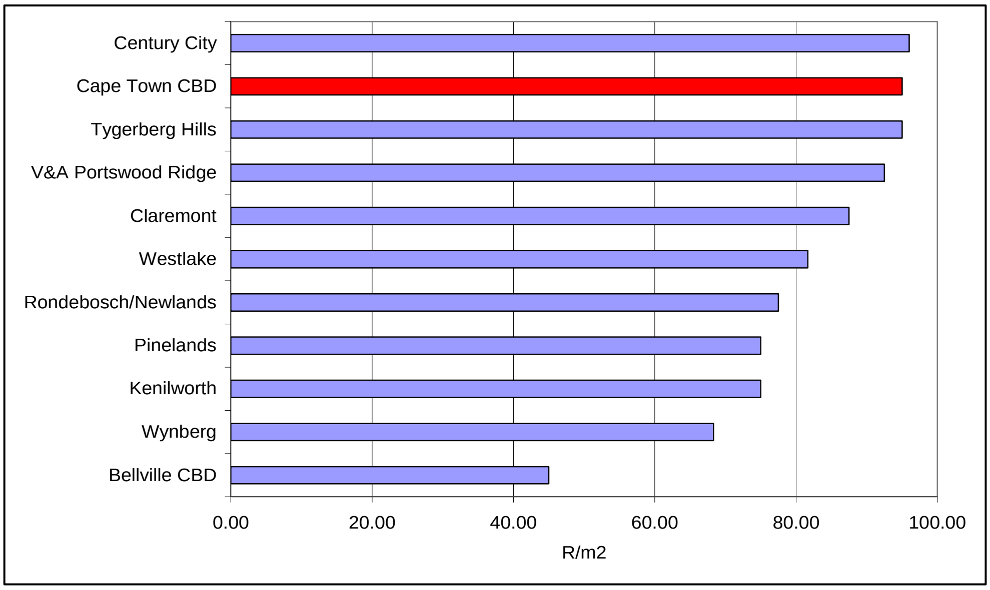
Graph 13: Market rental rates for office buildings (Pretoria) R/sqm

Source: Rode



Graph 14: Market rental rates for office buildings (Durban) R/sqm

Source: Rode 2007;3



Graph 15: Market rental rates for office buildings (Cape Town) R/sqm

Source: Rode 2007;3

These graphs are revealing in that they illustrate the existence of an office or commercial 'ladder' in the South African property market, providing a relatively seamless continuum of rental opportunities at a wide variety of rental prices. At present the Johannesburg property market spans a rental range that starts at R 60/m² in the CBD to anything between R100 – R150/m² in Sandton. Of course, even a rate of R60/m² may be out of reach of many smaller businesses. Nonetheless, the existence of a gradation in the price of office stock is a core outcome and a symptom of the operation of a functional and dynamic market for urban commercial space.

The ebb and flow in the demand for and prices of different spatial locations gives rise to rental opportunities for market entrants at different income levels. It also presents opportunities for investors to enter underperforming areas and to translate these into profitable conversion and upgrading opportunities, so as to tap market demand. As we shall see subsequently, the initiation of this market conversion process frequently depends on the judicious intervention and support of the state operating as a market facilitator – whether directly through targeted incentives or through effectively addressing the causes of decline, such as crime, poor transport services and infrastructure.

The diagram below illustrates that, while in the 1980s the yields that could be secured on an office development were comparable across nodes, this has changed in recent decades, with high demand nodes showing significantly stronger investment yields than less attractive suburbs.

[redacted]

Graph 16: Office capitalisation rates

Source: Rode, 2007:3

The outcome of different rentals and yields in different nodes across South African metropolitan areas has led to certain nodes growing faster than others. Thus, in the Johannesburg area the total office stock in the period 2001- 2006 has increased by some 93.62% in Constantia Kloof, 79.38 % in Fourways and 63.44% in Illovo. In Cape Town, Bellville saw a 47.70% rise in stock, and in Durban the Umhlanga area saw total stock rise by 46.90%.

In all sectors of the commercial market, property returns have been driven by rising rentals and the strengthening of yields, which is being driven by the high appetite, itself a symptom of a rising market, for investment properties by major investors and the listed property sector in particular. Long-term forecasts for the commercial property sector remain positive. In keeping with global trends, the focus is likely to move towards integrated developments that offer an appropriate mix between residential and office properties. Developers will also increasingly turn towards inner-city land which offers relatively good infrastructure and which is easier to develop from an environmental perspective.

2.4. THE RESIDENTIAL SECTOR

Apartheid created an urban fragmentation in the commercial and residential property markets that continues to this day. Although this fragmentation was largely driven by political considerations, today the legacy of highly skewed incomes, high rates of unemployment, availability of funding, poor public transport networks and infrastructure backlogs perpetuate these discrepancies. On the other hand, enhanced public funding, rising disposable incomes (particularly associated with the emerging black middle class), low-cost housing interventions, well crafted incentives and related land-use management policies are beginning to improve the integration of our cities.

In particular, recent experience suggests that integration and mobility in the residential sector is improving, with lower-middle income groups finding opportunities to locate closer to work and in areas which were previously beyond their reach. This is being partially addressed by the development and conversion of affordable residential stock close to and within the CBDs of SA’s cities.

South African cities also appear to be experiencing an increasing trend towards residential ‘filtering’. This describes the phenomenon whereby higher-income households in certain suburbs move out, giving way to lower-income households, who in turn have ‘graduated’ from lower-income suburbs. This process of upward filtering depends on, and simultaneously creates and reinforces, the existence of graduated housing prices, which enables people to migrate up the house price continuum, depending on the improvement in their material circumstances. This is discussed in more detail below.

Nonetheless, although there has been a noticeable movement of historically excluded South Africans into formerly ‘white’ suburbs, in most sectors of the city the actual numbers and percentages of black buyers in the total pool of property transactions have remained low. It has been estimated that black households are the buyers in a quarter of sales in the Johannesburg property sector, although some suburbs are showing much higher percentages.

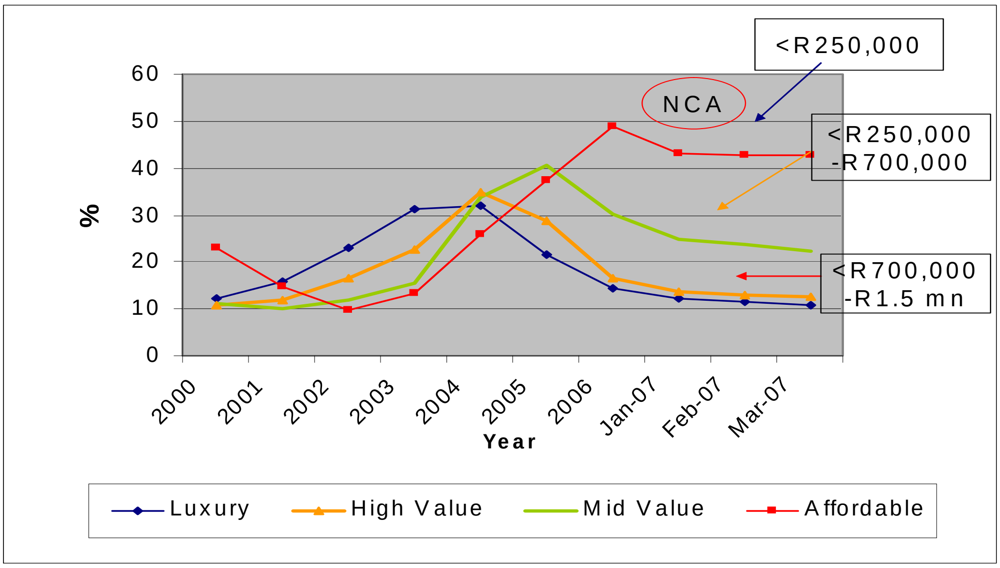
Although the CBDs offer relatively attractive residential locations, as they offer an appropriate balance between housing and access to employment opportunities, rentals are, especially at the lower end of the market, often insufficient to meet required returns. Market experience suggests that this leads to inadequate maintenance and urban decay, particularly if the pace of social infrastructure development in the inner cities (such as schools, clinics, recreational facilities and police stations) does not keep up with demand. The future success of the inner city as a location for large-scale housing provision does not only rely on the provision of adequate social services, it also frequently relies on the introduction of targeted incentives to ameliorate the perceived risks faced by private investors (as is evidenced by the success of Urban Development Zone incentives, discussed earlier). This confers a particularly important role on the state at the local level, as a market facilitator rather than a direct player.

In trying to understand the affordability of the South African residential property market, it is worth noting that the decline in South African interest rates in the capital segment of the market, combined with a relatively strong and stable macro economy, provided a catalyst for investment in the residential property market. This trend was reinforced by two additional factors, one internal and one external to the SA economy: the first reflected the rapid emergence since 1994 of a black middle class – people who were formerly excluded from participating in the economy and benefiting from its success. The second reflected strong growth in the world economy, and a particularly strong and sustained rate of increase in house prices globally. In 2005 the residential property market in South Africa recorded a growth of 35%, resulting in a decline in the overall level of affordability. The graph below shows the annualised rate of house price inflation (by month) compared with the mortgage interest rate from January 2000 until September 2007.

Graph 17: ABSA House Price Index

Source: ABSA

Although capital growth in the residential property market has slowed in the past two years (2006 - 2007**Error! Reference source not found.**), demand has remained particularly strong at the lower end of the market, driven by a shortage of housing stock and growing disposable incomes. The following graph illustrates that the lower end of the market is currently experiencing price increases of some 40% per annum. With a CPI inflation rate of 6%, affordability in this sector of the market is weakening significantly.



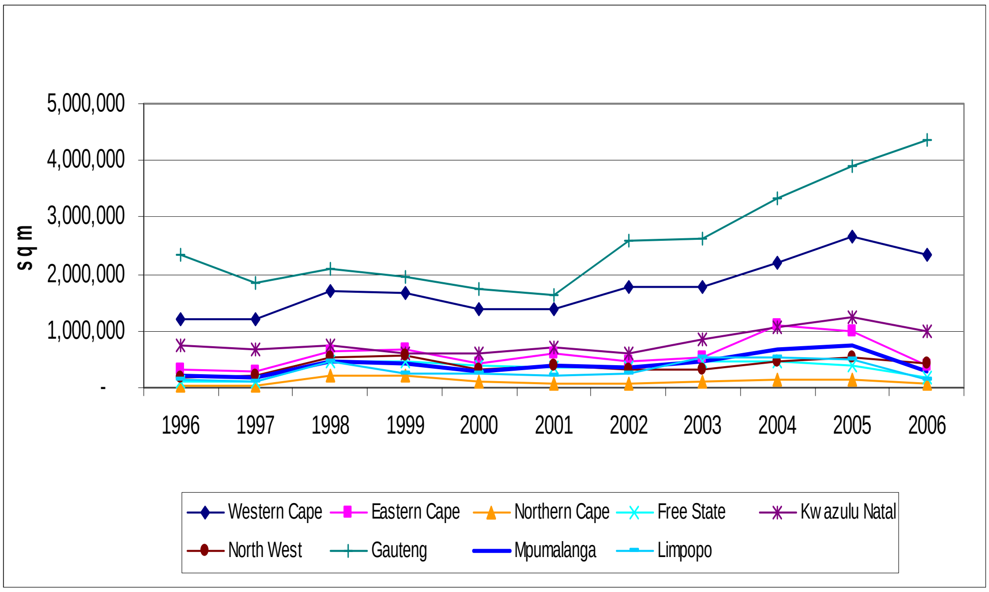
Graph 18: House price increases (different sectors)

Source: Lightstone

The enforcement of the National Credit Act in June 2007, combined with the rise in interest rates, has further reduced the affordability of the housing market in general. Slower house price growth is expected to remain a feature of the market in the medium term, depending on the future course of interest rates.

Graph 18 also illustrates the cyclical nature of the property market, with affordable housing only growing at 10% in 2002/3, while the same property segment is now growing at over 40%. The same could be said for high-value housing, which grew at around 35% in 2004 and is now only experiencing growth of just over 10%.

Graph 19**Error! Reference source not found.** illustrates residential buildings plans completed. This indicates the different regional trends in residential property activity across SA, and highlights the disproportionately strong growth experienced in Gauteng and the Western Cape.



Graph 19: Residential building plans completed

Source: StatsSA

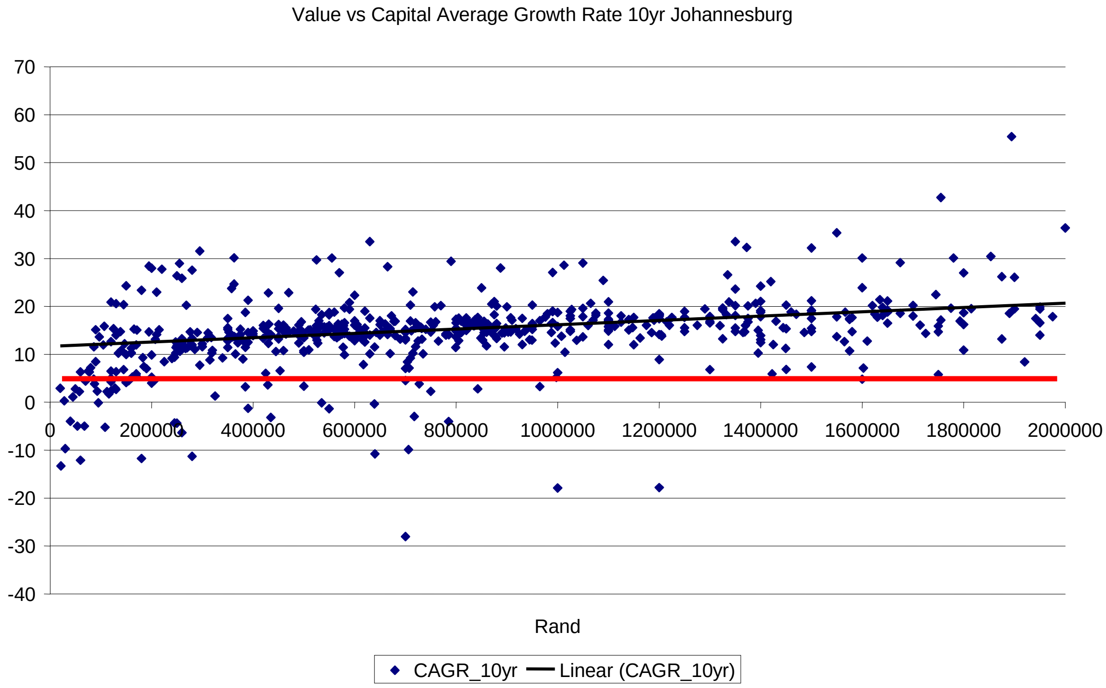
GROWTH IN HOUSE PRICES IS NOT UNIFORM

Whilst the strong growth in property prices in South Africa over the past ten years has already been highlighted, it is important to note that this growth is not uniformly experienced by all suburbs. Some suburbs may experience above-average growth, while others may experience a decline in property prices. As part of this study, data was obtained from the deeds office in order to analyse these changes in property prices at a more detailed level[3]. The data revealed interesting patterns in the median house prices of suburbs over the past ten years. The following section explores this in more detail, first using the example of Johannesburg and then exploring this phenomenon in other South African cities.

The different growth rates across suburbs are shown in Graph 20, which illustrates the ten-year average capital growth rate that has occurred across different suburbs in

[3] These data were provided by Knowledge Factory. Detailed mapping exercises were also undertaken using the same data set but representing the data spatially. These maps are presented in a separate mapping addendum. These maps do not add significantly, if at all, to the data analysis undertaken for this project. They have therefore not been analysed in any detail.

Johannesburg. This graph differs from Graph 18 in that it shows the average growth rate over the period, whereas Graph 18 illustrates the cyclical nature of property prices. The X-axis illustrates the median values of suburbs up to R2 million, while the Y-axis shows the capital annual growth rate (CAGR) between 1996 and 2007. The graph shows that most suburbs saw capital growth in the range of 10% - 20%. The data suggest that a number of suburbs in the Johannesburg metropolitan area have shown growth well below the average (below the trend line), and below the inflation rate (the red line), which would have been approximately 5% over the period. This suggests that these suburbs have become more affordable, with many experiencing negative growth rates over the period. It is also interesting to note that the majority of suburbs falling below the inflation line have a median price below R200 000. These suburbs are outliers in the general trend of capital appreciation experienced in this segment of the market.



Graph 20: Value vs capital average growth rate: 10yrs Johannesburg

Source: Genesis Analytics, Knowledge Factory

To illustrate the links between property prices and affordability, Table 6 below shows median house prices in 1996 and 2007 for a selection of suburbs in Johannesburg. In each case, a calculation was performed[4] to calculate the income required to repay a 100% mortgage on the median property. This provides an indication of the income needed to enter the property market in each suburb in 1996 and in 2007. To allow comparisons, the income for 1996 was adjusted to reflect real terms, i.e. taking into account inflation over the period.

Starting with suburbs at the upper level of the entry point to the formal housing market, the median price for a property in Yeoville increased from R85 000 in 1996 to R162 500 at present. An owner with a 100% bond, at 14.5% over 20 years, would thus at present require a monthly income of some R7 012 to acquire a median Yeoville property. In real terms (i.e. discounting inflation), entering the Yeoville property market in 1996 would have required a monthly income of R6 320. This suggests that over the period, the Yeoville residential property market has become somewhat *less* affordable, because property prices have grown at a higher rate than inflation and hence income. This argument is equally true for suburbs such as Meadowlands, Berea, and Bellevue Central.

On the other hand, the data show that a nearby suburb such as Jeppestown has become significantly *more* affordable, with the required household income needed to enter the suburb declining from R26 210 in 2006 to the present R8 199. Table 6 illustrates a similar trend in Marlboro South, which has seen the required household income decline from R18 588 to R11 587. Other suburbs which have become more affordable are bolded in the table.

	2007		1996		2007 Real Terms	CAGR 10yr%
Suburb	**Value**	**Income**	**Value**	**Income**		
Meadowlands	160000	R 6,904.74	R 65,000.00	R 2,805.05	R 4,833.10	11.26
Yeoville	162500	R 7,012.63	R 85,000.00	R 3,668.14	R 6,320.21	5.29
Berea	182842	R 7,890.48	R 60,000.00	R 2,589.28	R 4,461.33	9.32
Bellevue central	185000	R 7,983.61	R 91,500.00	R 3,948.65	R 6,803.52	7.47
Jeppestown	190000	**R 8,199.38**	R 352,500.00	R 15,212.01	**R 26,210.29**	7
Wilfordon (Roodepoort)	245000	**R 10,572.88**	R 228,000.00	R 9,839.26	**R 16,953.04**	-4.34
Bellevue East	245000	R 10,572.88	R 105,000.00	R 4,531.24	R 7,807.32	9.37
Lombardy West	255000	R 11,004.43	R 99,500.00	R 4,293.89	R 7,398.37	28.98
Rabie Ridge	260000	**R 11,220.20**	R 500,000.00	R 21,577.32	**R 37,177.71**	-6.33
Paarlshoop	267000	R 11,522.29	R 58,500.00	R 2,524.55	R 4,349.79	11.24

[4] This calculation was based on conventional assumptions, namely that a household spends 30% of its gross income on housing, takes a 100% bond re-payable over 20 years, and pays an interest rate of 14.5%

Marlboro South	268500	**R 11,587.02**	R 250,000.00	R 10,788.66	**R 18,588.86**	20.24

Table 6: Residential housing transition in Johannesburg

Source: Genesis Analytics, Knowledge Factory

An indication of the Johannesburg suburbs that have recorded a ten-year capital growth rate below the inflation rate and which would be considered to fall in the 'increasingly affordable' housing sector is illustrated in Table 2 below. As an example, the suburb of Denver experienced a negative capital growth of 11% over a ten-year period – and consequently has become much more affordable. A similar argument could be proposed for Pageview, which saw a capital growth of negative 5% over the period. In fact, any suburb which has experienced annual house price inflation of below 5% over the last ten years – i.e every suburb in the table - would have become more affordable to lower-end buyers.

The reasons for below-average or even negative growth are varied, and in some cases can be attributed to urban decay as a suburb goes through a downward cycle. This may be caused by any number of factors internal or external to the particular suburb in question. The densification of a suburb would also result in lower-value properties as larger, more expensive properties are subdivided into smaller, less expensive units. In our data this would manifest in a below-average performance of the suburb, as on average the price would be declining.

Nonetheless, in an environment of otherwise rapidly increasing property prices, suburbs with declining prices represent an entry point for those who might not otherwise have been able to afford to live in these generally well located areas. As prices fall, the income required to own property in the area declines. This allows those previously excluded on the basis of price to enter the suburb and own property in areas from which they were previously excluded.

At this point it is important to make some cautionary observations about the nature of the data being analysed. A few large transactions within one suburb can act to influence the CAGR and hence obfuscate the real trend in prices. Most importantly, the data does not allow for an evaluation of the *amount* of stock being sold. In some cases only a few properties might be sold in a suburb, and these properties may not be entirely representative of the remaining stock. One might therefore incorrectly make inferences about the value of properties within the suburb. In addition, the low turnover or 'churn' in a suburb could mean that while affordability is increasing, in reality people are unable to move into the suburb as there are only a few properties available for purchase.

Table 7 below shows the full list of suburbs in the Johannesburg metropolitan area which have become more affordable over the past ten years.

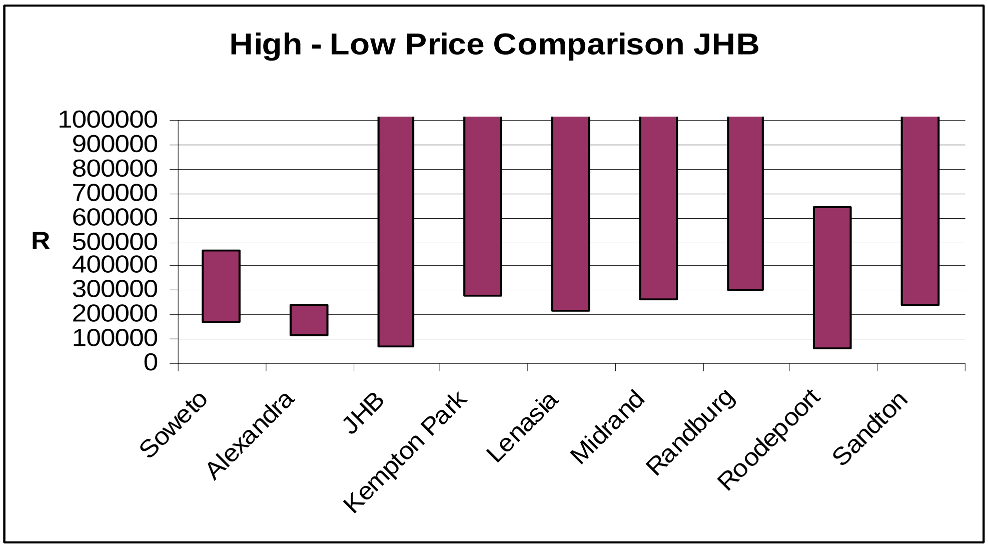
SUBURB	Median Value 2007	CAGR 10yr
ALEXANDRA	116000	1.75256
ARMADALE	108300	-5.21368
BELLEVUE	150000	4.13797
BRAAMFISCHERVILLE	180000	-11.7326
CHIAWELO EXT 3	128000	2.97236
DENVER	280000	-11.3019
DIEPKLOOF ZONE 1	95000	-0.104658
DIEPKLOOF ZONE 3	45000	1.10169
DIEPKLOOF ZONE 5	120000	5.0242
DRIEZIEK EXT 2	155000	4.48
ENNERDALE EXT 6	21600	-13.2996
FOX LAKE	30000	-9.67576
HIGHLANDS	150000	4.40196
KIMBULT AH	250000	-4.34943
LAKESIDE EXT 1	20000	2.9186
LAWLEY EXT 1	130000	2.65836
LENASIA EXT 11	40000	-3.97355
LENASIA SOUTH EXT 4	112000	2.21098
MEADOWLANDS EAST ZONE 5	93000	2.31166
MEADOWLANDS WEST ZONE 10	120000	4.26905
MEADOWLANDS WEST ZONE 7	50000	2.78237
MEADOWLANDS WEST ZONE 8	87500	3.84502
MOFOLO NORTH	57895	2.21598
MOLAPO	70000	4.40196
MOROKA	54000	-4.97998
NALEDI EXT 1	86000	4.86111
NANCEFIELD INDUSTRIAL	325000	1.32202
PAGEVIEW	67747	-4.98741
PIONEER PARK	390000	-1.26615
PROTEA SOUTH	120000	2.36365
RABIE RIDGE	260000	-6.33004
RICHMOND	385000	3.23579
STORMILL	60000	-12.1039
UNAVILLE AH	200000	4.00869
WESTBURY	27826	0.301794
WILFORDON	245000	-4.34543

WOLHUTER	205000	4.50041

Table 7: Johannesburg suburbs which have become more affordable

Source: Genesis Analytics, Knowledge Factory

It is interesting to note that a further analysis of median house prices across Johannesburg suburbs suggests that a considerable value overlap in price exists between residential suburbs in township and suburban areas. This is significant, as it indicates that inter-suburb price 'cliffs' that historically inhibited mobility between township and formerly white areas may be eroding.



Graph 21: High-low price comparison: Johannesburg

Source: Genesis Analytics, Knowledge Factory

Graph 21 above presents an illustrative sample of suburbs, and suggests that the Soweto property market operates in a range from just below R 200 000 to R 450 000. This range overlaps with most of the other suburbs in the Johannesburg metropolitan area. Thus, households that can afford a house of R 250 000 in Soweto should be in a position to find a similarly priced house or a flat across most of the Johannesburg metropolitan area. Households in municipal areas such as Roodepoort, Alexandra and Johannesburg should be in a position to find housing below a median household income of R 250 000. This indicates that the market has begun to work effectively and of its own accord to start overcoming the racially defined divisions of the past. Of course, there may be a very limited stock of houses in these price ranges, which would in reality prevent households from moving from a high-end Soweto suburb to a lower-end Kempton Park suburb. Nonetheless, the overlapping price ranges provide some interesting insights into the improving dynamics of the urban residential property market.

SMOOTH PRICE GRADIENTS BETWEEN SUBURBS ARE EMERGING

Data from the deeds office also revealed that across the major metropolitan areas of South Africa, there is a relatively smooth property price gradient emerging between suburbs. This section provides an analysis of available data which illustrates the extent to which this is occurring.

Conventional wisdom amongst many housing sector commentators is that lower income groups face significant gaps and 'price cliffs' along the commercial residential property ladder, making it difficult for historically excluded households to move out of the townships and into suburbs closer to city centres and places of work. The data however provide the first indications that these price cliffs may not be as substantial as previously thought.

Table 6[5] in the above section suggests that it has become relatively easy to make the step from, say, a suburb in Soweto to the Johannesburg inner city. In 2007 the median property value in Meadowlands was R 160 000, with the median property value in Yeoville being R 162 500. As this gap is relatively small, it suggests that the movement up the property ladder in this band is quite possible. The movement may of course mean trading off a well located flat in the city centre against a house in Soweto. Table 6 also illustrates that the residential property market moves in small incremental steps across most of the affordable suburbs in Johannesburg

Obviously as will be seen below, affordability issues at the lower end impose a limit on the extent to which this gradient extends into poorer communities, but the existence of a fairly smooth price gradient across cities is an important development in the normalisation of the urban residential housing market after apartheid. Once again, the issue of available stock has to be understood, as in reality there may be relatively low turnover or churn at the lower end of the market.

APPLICABILITY ACROSS SOUTH AFRICA

An analysis of the Cape Town and Durban property markets shows similar trends to those discussed above. As in the case of Johannesburg, certain suburbs were chosen that are transitional in nature – namely those straddling the township and

[5] The suburbs in this table were selected to show the transition or overlap from traditional township suburbs (eg Meadowlands) to formerly white suburbs (eg Jeppestown)

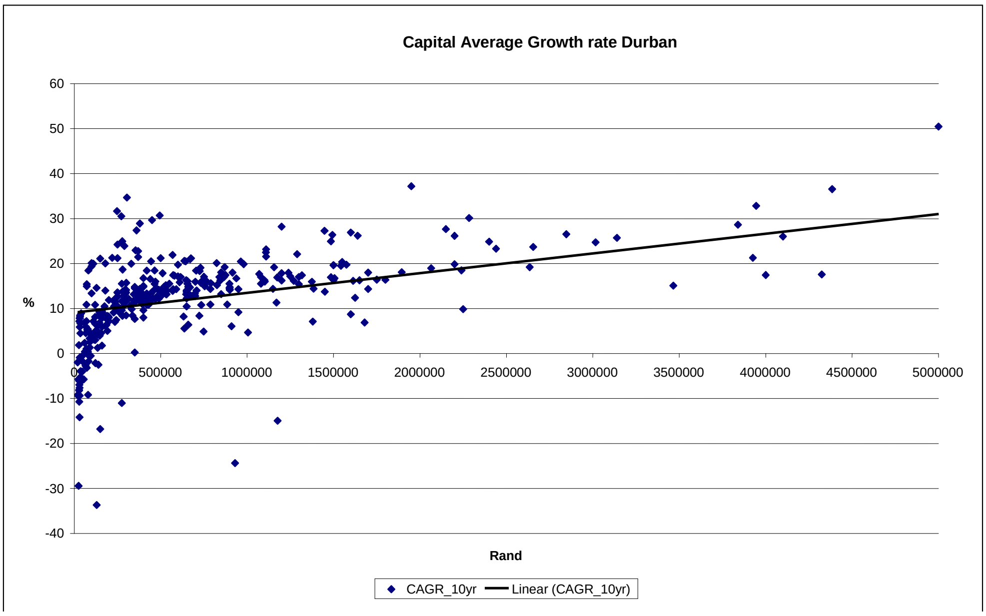
suburban residential markets. In Durban the market gradually moves from Umlazi, with a median property value of R145 000, to R192 000 in Centenary Park. Market trends for these transitional suburbs suggest that while Umlazi has experienced strong growth in prices and hence has become less affordable, the suburbs where median prices are around R160 000 have become more affordable over the same period.

An analysis of market growth rates in Durban (Graph 22) suggests that, while some of the low-value suburbs have seen little growth (thereby making them more affordable), very few suburbs in the middle market have seen growth trends below the average. There is also evidence that households presently situated in former township areas such as Umlazi can move across to other suburbs in the Durban metropolitan area (Graph 23). Suburbs that have become more affordable in the Durban metropolitan area include Marian Ridge, Mount Mariah and Chesterville.

	2007		1996		2007 Real Terms	CAGR 10yr%
Suburb	Value	Income	Value	Income		
Umlazi	R 145,000.00	R 6,257.42	R 15,000.00	R 647.32	R 1,115.33	6.80
Chesterville	R 150,000.00	R 6,473.19	R 17,000.00	R 733.63	R 1,264.04	-16.81
Ridgeview	R 150,000.00	R 6,473.19	R 16,000.00	R 690.47	R 1,189.69	21.10
Saibs Hill	R 150,000.00	R 6,473.19	R 170,000.00	R 7,336.29	R 12,640.42	9.14
Chelmsford Heights	R 160,000.00	R 6,904.74	R 95,000.00	R 4,099.69	R 7,063.77	1.75
Lamont Ville	R 160,000.00	R 6,904.74	R 87,000.00	R 3,754.45	R 6,468.92	9,87
Nirvana Hills	R 180,000.00	R 7,767.83	R 28,496.00	R 1,229.73	R 2,118.83	20.02
Centenary Park	R 192,000.00	R 8,285.69	R 135,500.00	R 5,847.45	R 10,075.16	5.03
Durban Central	R 300,000.00	R 12,946.39	R 88,000.00	R 3,797.61	R 6,543.28	13.57

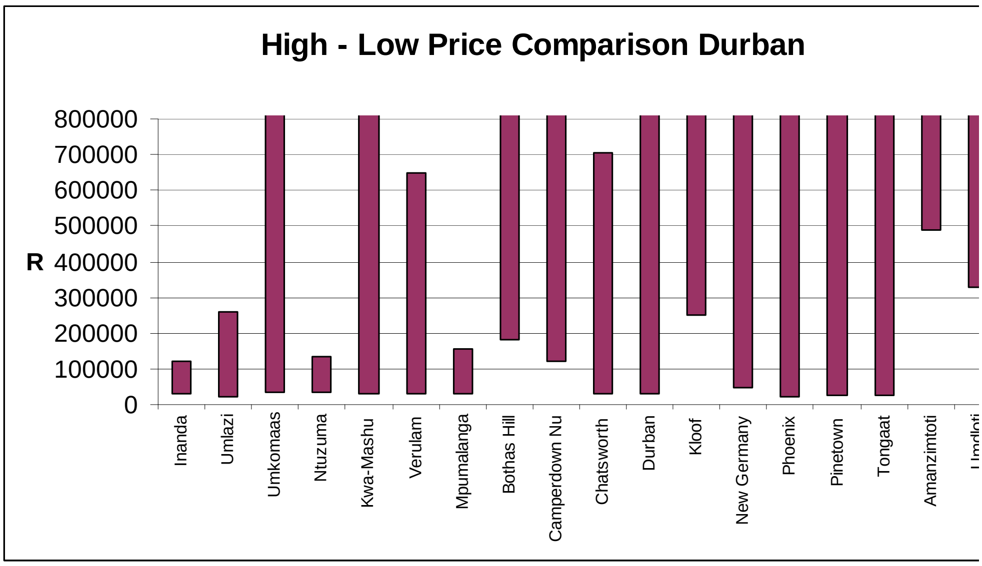
Table 8: The residential housing transition: Durban

Source: Genesis Analytics, Knowledge Factory



Graph 22: Capital annual growth rate: Durban

Source: Genesis Analytics, Knowledge Factory



Graph 23: High-Low Price Comparison Durban

Source: Genesis Analytics, Knowledge Factory

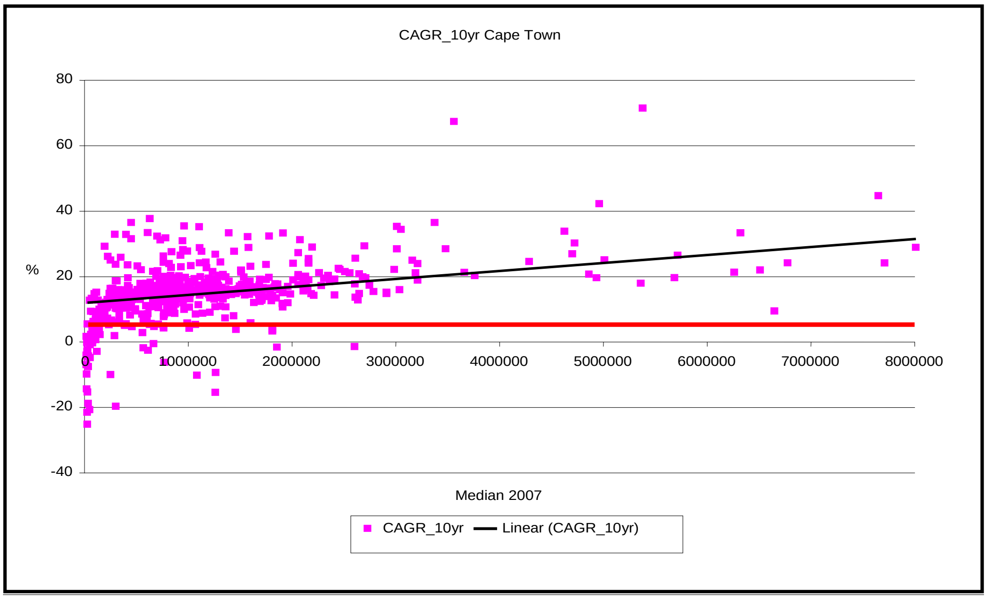
Some suburbs in the Cape Town metropolitan area, such as Belleglen, Bellville Centre, Hanover Park and Leonsdale, have become suburban alternatives to former township areas, as these areas are closely comparable in value. In addition, these areas may have a spatial advantage in that they are better located than townships which often occupy the urban periphery. These suburbs have experienced below-inflation capital growth.

In Cape Town, the residential property market comprises a gradient which ranges from Graceland (Khayelitsha) at a median value of R130 000 up to Helderzight (R247 500). Again, the growth in price varies significantly between suburbs. For example, Klipfontein village seems to have improved in affordability, whilst a suburb such as Sherwood has become less affordable. An inter-suburb comparison suggests that a household in Khayelitsha or Gugulethu should be in a position to find accommodation in Blue Downs, Atlantis, Cape Town, Macassar or Mitchell's Plain. It is however unlikely that such households will be in a position to acquire properties close to the CBD where median prices seem to be in the region of R2 million. This is largely a function of the fact that the Cape Town CBD has not experienced urban decay and is a highly desirable, upper-income area.

	2007		1996		2007	CAGR
Suburb	Value	Income	Value	Income	Real Terms	10yr%
Graceland (Khayelitsha)	R130,000.00	R5,610.10	60000	R2,589.28	R4,461.33	4.58
Casablanca	R130,500.00	R5,631.68	R32,000.00	R1,380.95	R2,379.37	12.83
Balvenie	R142,000.00	R6,127.96	R279,000.00	R12,040.14	R20,745.16	4.32
Bishop Lavis	R170,000.00	R7,336.29	R67,000.00	R2,891.36	R4,981.81	10.97
Clarkes	R180,000.00	R7,767.83	R54,000.00	R2,330.35	R4,015.19	9.14
Klipfontein Village (Mitchells Plain)	R195,000.00	R8,415.15	R150,000.00	R6,473.19	R11,153.31	29.23
Silverton	R195,000.00	R8,415.15	R150,000.00	R6,473.19	R11,153.31	8.4
South End	R202,500.00	R8,738.81	R75,000.00	R3,236.60	R5,576.66	11.86
Scottsdene Ext	R205,900.00	R8,885.54	R172,208.00	R7,431.57	R12,804.60	12.13
The Conifers	R210,000.00	R9,062.47	R75,000.00	R3,236.60	R5,576.66	10.41
Macassar	R220,000.00	R9,494.02	R63,000.00	R2,718.74	R4,684.39	12.96
Sherwood	R247,500.00	R10,680.77	R59,000.00	R2,546.12	R4,386.97	11.29
Helderzicht	R247,500.00	R10,680.77	R120,000.00	R5,178.56	R8,922.65	6.36

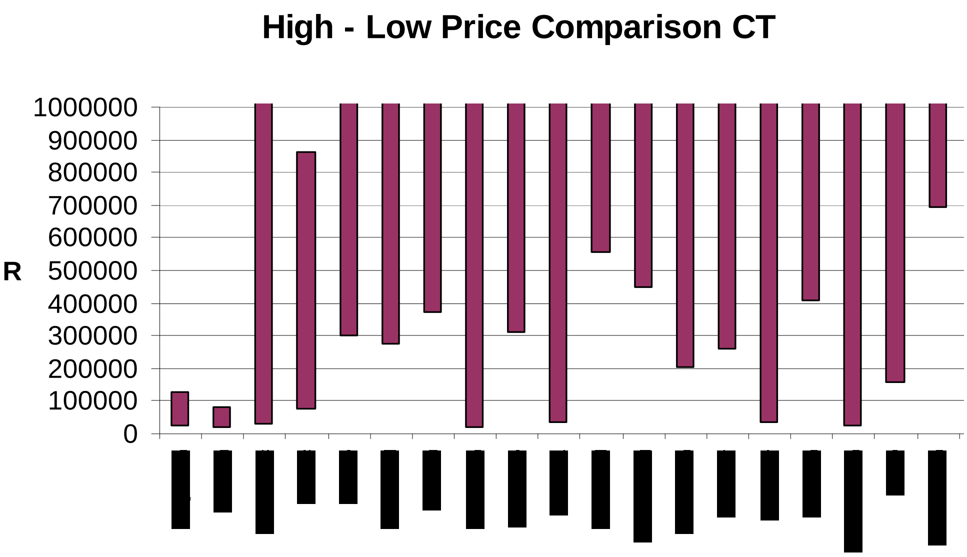
Table 9: The residential housing transition: Cape Town

Source: Genesis Analytics, Knowledge Factory



Graph 24: Capital annual growth rate: Cape Town

Source: Genesis Analytics, Knowledge Factory

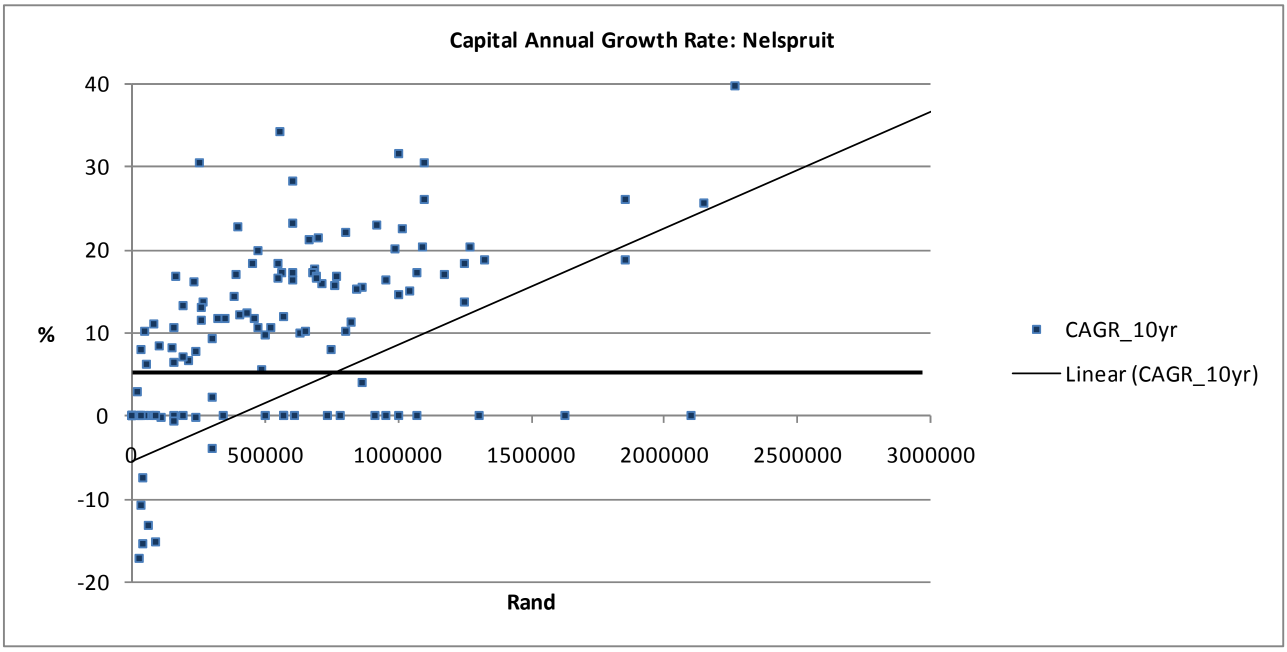


Graph 25: High-low comparison: Cape Town

Source: Genesis Analytics, Knowledge Factory

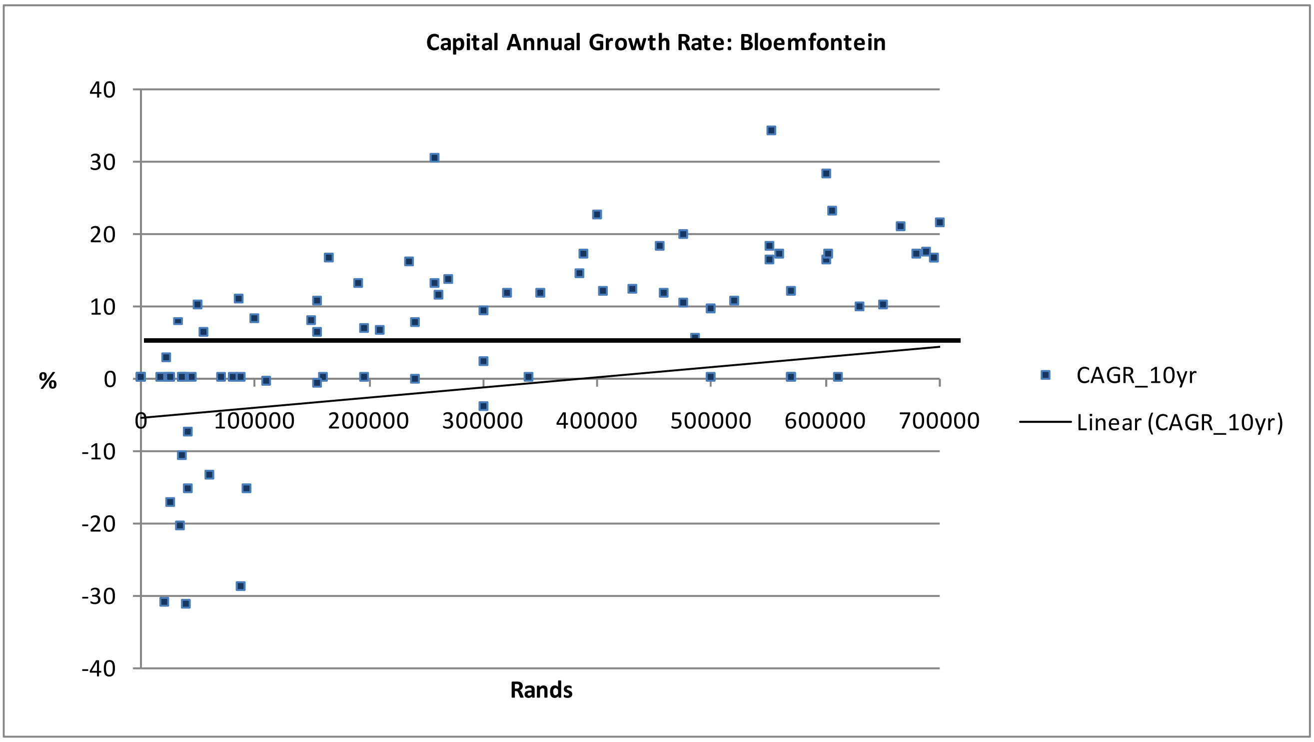
It is interesting to perform a similar analysis for Bloemfontein and Nelspruit, two smaller South African cities. Whilst the pattern of differential growth can clearly be seen, Nelspruit has relatively few suburbs which have become more affordable. Those that have are at the very lowest end of the market and may be reflecting inconsistencies in the data caused by one-off transactions in a particular area (usually agricultural). Most suburbs have experienced strong price growth over the past ten years. This can probably be attributed to the strong economic growth in the area as a result of the Maputo corridor, and the transformation of the Nelspruit economy away from a largely agricultural base. Since Nelspruit is also the provincial capital, many government employees are moving into the area and looking for accommodation. Supply of new housing stock has not been able to keep up with this strong demand and hence prices have been squeezed upwards. Nonetheless, certain areas have experienced price growth below the inflation rate, thereby increasing their affordability over the period. These suburbs tend to be those at the bottom end of the market, and it is possible that in the face of continued and unmet demand, prices in this segment will start to experience some growth.

In Bloemfontein there is a similar pattern to that of Nelspruit. Relatively few suburbs have become more affordable, and those that have tend to be at the lower end of the market. This suggests that the property market in these former township areas has not taken off to the extent seen in the major metros, or at the very least growth has not been uniform. The generally strong growth in property prices is attributed by some analysts to a virtual moratorium on development of infrastructure services by the local council in Bloemfontein (Property 24, 2008). This has restricted the amount of stock on the market and hence driven up prices in the face of sustained demand. Economic development in the area, partly due to the 2010 World Cup construction projects, is also driving demand for properties.



Graph 26: Capital Annual Growth Rate Nelspruit

Source: Genesis Analytics, Knowledge Factory



Graph 27: Capital annual growth rate: Bloemfontein

Source: Genesis Analytics, Knowledge Factory

The analysis above seems to suggest that, while larger metropolitan areas have shown a significant increase in entry points for the poor, in smaller towns or cities this has occurred to a lesser extent.

2.5. CONCLUSION

The South African residential and commercial property markets have been influenced by macro and micro/spatial trends which have resulted in significant changes in recent years. These changes have occurred in the space, capital, development and land segments of the residential and commercial markets

The macro-economic environment largely affects the potential growth of the property market. A change in macro-economic fundamentals influences the overall property market, but sectors within the market are affected differently, depending on the opportunities and constraints they provide. Yet the property market also needs to be understood from a micro perspective. Households and businesses search for optimal sites which reflect their material circumstances and spatial needs. For households this entails finding sites that offer an appropriate balance between home, work and play. For businesses it means finding sites that optimise returns. Competition for space within the property market manifests itself in changing prices, returns and rentals, and occurs both within sectors and across sectors.

The form that a property market takes is not only the outcome of interactions in the market, but is also affected by the institutional environment in which the market operates. Therefore, intervention by national, provincial and local government directly informs the efficiency, outcomes and spatial form of the market. For the property market, town planning, transaction support services, environmental and transport policies are of particular significance. The efficiency with which these functions are directed and fulfilled by the state at various levels will have a direct impact on the efficacy of the property market and its outcomes across all sectors.

Market data assembled as part of this research process suggest the emergence of an incremental ‘ladder’ in both the commercial and residential property sectors of metropolitan areas. In the office sector, the market offers space in numerous nodes at different rentals, although there is a distinct floor to the price of available rental accommodation in the formal sector, presenting a barrier to small and emerging market players. In the formal office sector it is possible for entrepreneurs to enter the office market at rentals that are at least half those of prime area rentals.

In the residential sector there is evidence of differential price growth between suburbs – although determining the depth of these markets would require further research beyond the brief of this project. Where metropolitan suburbs have experienced growth below the rate of inflation, or even negative growth, they have become more affordable for historically excluded households wishing to enter the commercial housing market or to exit the ‘township’ market. In addition, there is evidence of a significant overlap in the property prices of different suburbs across townships and suburbs across all metropolitan areas. This is true of almost all price segments of the market, including the lower end of the formal market. This offers households a broad choice of residential opportunities, and suggests that as macro-economic conditions improve, households entering the commercial market will be able to move between suburbs without encountering insurmountable price cliffs.

The challenge for both the public and private sector is to explore mechanisms and instruments with which to extend the formal market further ‘down’ and to improve the affordability of its lower end. To do this in a manner which is compatible with the operation of the market is likely to require careful coordination between the housing subsidy policies of government and the private sector; the implementation of effective planning and transactional support services at a local level; and the development and extension of innovative approaches to incentivising private investment in urban upgrading and densification.

3. POLICY & REGULATORY FRAMEWORK

3.1. INTRODUCTION

As outlined in section 1, in attempting to understand the functioning of land markets, it is necessary to be aware of the institutional framework in which land is transacted. This framework extends from the government's constitutional mandates to its policy intentions and legislative and regulatory prescriptions. This section of the report therefore provides an understanding of the key components that make up the institutional framework that supports the urban property market. While the focus of the overall exercise is on urban land, it is necessary to engage with government policy, and specifically its housing policy, The policy and programme imperatives that flow from this, particularly in relation to low-cost housing, have and will continue to have an effect on the property market and have the potential to continue to affect it over time.

From the earliest days of South Africa's democratic government, a consistent theme has run through its land, housing and urban policies, namely that the cities and towns across the country must be 'integrated'. Over the past 15 years, government policies and programmes have come to reflect this desire to redress the apartheid legacy of separation between whites and blacks, especially where people may reside.

Initially, government policy sought to provide historically disadvantaged South Africans with rudimentary houses and formal tenure. Unhappiness with the location of over 1 million subsidy houses situated on the urban periphery eventually resulted in a policy shift towards the creation of 'sustainable human settlements' with a focus on housing people close to economic opportunities and urban amenities. Sustainable human settlements are viewed as areas of mixed usage, which combine various housing typologies and different income groups.

Over time, government has moved from local planning exercises[6] aimed at developing 'land use guidelines', which aim to limit urban sprawl, integrate urban areas and direct infrastructure provision, to proposing that future development needs to be carried out in an 'inclusionary' manner. This represents an increasingly interventionist approach in planning policy. One of the consequences of limiting urban sprawl through the implementation of, say, an 'urban edge' is that developable land for either residential, commercial or industrial use is becoming scarcer and therefore more costly over time. Moreover, municipalities are fast running up against

[6] Government expects planning exercises to be carried out in a participative manner that will result in the linking of local demand to actual plans, programmes and budgets.

a lack of affordable urban land on which to settle the poor. As South Africa's metropolitan areas follow the path of international cities around the world, where well located land has become an expensive and scarce commodity, government is proposing the establishment of an institutional response aimed at facilitating the acquisition of this well located land for the poor.

Reflecting these concerns, the state has at various levels come to adopt a more interventionist approach to the property market; this being seen as a pre-requisite for meeting its transformational goals, since housing subsidies and local level planning interventions (e.g. Integrated Development Planning exercises - elaborated further below) are not having the desired effect at the desired pace[7]. The discussion in section 1 indicates that the actual degree and the form of intervention government should consider is a point of debate. With respect to planning exercises aimed at ensuring development objectives are met, a currently emerging view within government is that guidelines may be insufficient and that government should be more prescriptive and interventionist, while others are of the view that such prescriptions may be ineffective and may indeed undermine the market's ability to contribute to delivery - unless they are well conceived, flexible and can address the specifics of local constraints, rather than simply extrapolate national imperatives to the local level.

The state has a critical role to play in ensuring that urban land markets function efficiently and effectively. A tangible demonstration of this is the fact that land markets rely on the state to administer a land registration system, as secure title deeds are the foundation for collateralised lending, in turn a pre-requisite for efficiently functioning property markets throughout the world. South Africa stands alone on the continent in terms of having a developed formal land registration and tenure system. In contrast and in the absence of any systematic titling system, land in most of the rest of Africa is primarily tribally or informally held according to customary rules and norms, or else, over time, the state has taken it over. Unable to own, capitalise or leverage formal land, the majority of African urban populations typically reside in informal and unplanned settlements, unable to use the power of the market, its institutions, actors and instruments to progressively overcome their circumstances. This illustrates the uniquely important role of the state in enabling the property market to work effectively – in this case ensuring that an institutional framework for land rights exists, and that it is administered efficiently. Similarly, at a local level, the state fulfils a variety of critical planning, regulatory and enforcement functions relating both

[7] President Mbeki at the South African Local Government Association (SALGA) conference in 2007, noted a lack of adequate progress in transforming apartheid settlement patterns due to municipalities continually allocating well located land to developers for upmarket developments.

to the transactions process as well as the enforcement of the ‘rules of the game’, which are prerequisites for the effective operation of local property markets.

The remainder of this section will explore the role the South African state has adopted in fulfilling its regulatory functions in the SA property market, and the impact it has had. It will do so by:

- setting out the Constitutional mandates with respect to land, housing and planning as they provide the imperatives and justification for the direction of the state;
- setting out the policy and legislative framework for land administration, land planning and housing delivery;
- describing current and proposed government interventions aimed at ‘integration’ and their impact on the market; and
- highlighting the impact of and drawing conclusions from the experience of the above.

3.2. CONSTITUTIONAL POWERS AND FUNCTIONS FOR LAND, HOUSING AND PLANNING

Prior to describing the regulatory framework around land, housing and planning, it is important to begin with the South African Constitution and to describe both the guarantees it provides as well as where responsibility lies for state functions. This is important because the Constitution sets out the imperatives that drive government in its policy-making process.

The Bill of Rights guarantees existing property rights, but simultaneously places the state under a constitutional mandate to take reasonable steps to enable citizens to gain equitable access to land. It further promotes security of tenure.

The Bill of Rights also guarantees that everyone has a right to have access to adequate housing and that the state must take all reasonable legislative and other measures, within its available resources, to achieve the progressive realisation of this right. Similar to the guarantee over existing property rights, no one may be evicted from their home, or have their home demolished, without an order from the court after considering all the relevant circumstances. Clearly the South African government is compelled to fulfil land and housing provisions for a significant portion of its population, something most other Western governments are not expected to fulfil.

Where the powers and functions lie in terms of these mandates, however, is less straightforward when it comes to housing than when it comes to land. Housing is described in Schedule 4A of the Constitution as a functional area of *concurrent* competence between national and provincial government. Provincial government, however, *does not* have a responsibility for land, in the same way as it does for housing. In other words, land is a national function.

Moreover, when it comes to both regional planning and urban development, both essential to the operation of urban land markets, Schedule 4A also describes these as functional areas of *concurrent* competence between national and provincial government. However, the various planning functions are left undefined. Later on in this section it will become apparent how confusing this mandate is, in particular, when it comes to land planning, and the consequences it has for planning outcomes.

At the same, time neither Schedules 4B or 5B of the Constitution include housing as a function of local government, except through the principle of devolution, whereby national and provincial government must assign or delegate to a municipality by agreement a matter that would most effectively be administered locally, and where the municipality has the capacity to administer it.

Notwithstanding the above, it is municipalities that play the central role in land planning. Schedule 4B states that municipal planning is a local government matter necessary to ensure orderly and sustainable development and provide security of land rights. This mandate results in the requirement for land to be zoned as the basis for residential, commercial and industrial development.

3.3. POLICY & LEGISLATIVE FRAMEWORK: LAND ADMINISTRATION AND PLANNING ISSUES

The previous section set out the c*onstitutional mandates* around land, housing and planning. This section will focus on the *key policy* and *legislative mandates* around land administration and land planning issues and their potential to affect the urban land market.

The 2001 *White Paper on Spatial Planning and Land Use Management* addresses the complexity in which the Constitution deals with the competency of planning. Whereas Schedules 4 and 5 of the Constitution do not attempt to define the various planning functions, the *White Paper* deals with this issue by arguing that the Minister of Land Affairs is responsible for the administration, ownership, distribution and surveying of land, as well as its use and development[8]. Municipalities are responsible for (*inter alia*):

- guaranteeing ownership and security of tenure;
- supporting land and property taxation;
- developing and monitoring land markets;
- improving urban planning and infrastructure development; and
- supporting environmental management[9]

These responsibilities, which are key to the successful functioning of land markets, fall primarily into two broad categories: 1) land administration/land use management; and 2) land planning, each with its own policy and legislative framework.

3.3.1. LAND ADMINISTRATION

Land administration primarily revolves around the surveying of specific erven of land, whereupon a title deed records the rights registered in favour of the land. The Surveyor-General's Office examines and approves cadastral surveys and compiles and maintains plans showing the relationship of different erven to each other. The Registrar of Deeds registers and maintains records relating to all registered parcels of land. This therefore represents the fundamental basis of the formal land market, in that transactions are formally recognised, and the unit of land being bought is defined spatially and contains certain rights.

The control of these powers is vested by statute in the Minister of Agriculture and Land Affairs as a means of ensuring uniform standards are applied countrywide. The legislation pertaining to land administration is assigned by the Minister to lower tiers of government (http://land.pwv.gov.za/home.htm).

Another fundamental role of government in land administration is the operation of a property rating system. South Africa's rates system has been under review and is in the process of being standardised across the country. The system is also being changed to extend it beyond simply rating land values but rather capturing improvements to the land as well. Government has committed itself to ensuring that rates do not increase unrealistically and provision is being made for special cases, e.g. pensioners, to be exempted from increases. The changes are viewed as a way to provide local government with the opportunity to increase its rates base so as to

[8] At present most of the legislation dealing with land administration is *assigned* by the Minister of Land Affairs, including legislation pertaining to land surveying and deeds registration

[9] http://land.pwv.gov.za/White%20Paper/white5.htm

enable investment in development, although some contend that the new system is driven by the goal of equity, rather than resource generation.

Despite the government's commitment to ensuring that rates do not increase unrealistically, the new valuation roll has caused controversy in almost all the major metros in which it has been implemented. This is largely because properties are being valued higher than property owners previously thought – implying increased rates. While in some cases mistakes have been made, in most cases property owners were simply not aware of the strong growth in property prices over the past ten years. This has led to some anomalies, with houses in the Bo-Kaap in Cape Town, a traditionally poor area with an exceptional location, being valued at up to R2 million. The rates associated with properties of this value are simply unaffordable for many of the residents. The Cape Town City Council is currently trying to find innovative solutions to this problem as there is a strong feeling that the unique cultural value of the area needs to be retained.

Clearly the government's role in land administration is vital to the functioning of a property market. On the one hand, South Africa's land administration system is extremely sound because the country has one of the most secure registration systems in the world – a situation which arose out of the early need to establish mining rights. On the other hand, the system has become less efficient over time, in part because nearly 2 million households have required title deeds over the past 14 years due to the rolling-out of the country's Housing Subsidy Programme[10]. Moreover, the informal sale and transfer of many subsidy houses following their initial allocation has diluted the clarity of title associated with them.

The Township Residential Property Market (TRPM) study (Shisaka Development Management Services. 2003, 2004a, 2004b) put a great deal of emphasis on a lack of title and took the view that this situation was undermining the functioning of the secondary property market. It is therefore imperative that government puts a high-priority focus on this issue, as formal title is a prerequisite for the effective operation of land markets.

TRANSACTION COSTS

One issue which is often highlighted when examining land administration is a concern that excessively high transaction costs can be a disincentive for the public to register transfers of land ownership. Transaction costs can include:

[10] Discussion on delays in the Deeds Office have been documented in FinMark's Township Property Market study (Shisaka Development Management Services, 2003, 2004a, 2004b).

- cadastral survey (pre-surveys and actual survey) fees;
- valuation fees[11];
- conveyance fees;
- stamp duty payable on leases, mortgage bonds, collateral bonds, etc.
- deeds registry fees; and
- transfer duty, or VAT[12], where the seller is a VAT vendor.

Cadastral surveys are required for the subdivision of undeveloped land. The fees charged by land surveyors are fully negotiable, but for the purchaser of a small parcel of land the cost can be quite high. Current practice is that valuation fees are calculated according to a time charge or a fee based on the value of the land. Whilst these costs may be high, they are necessary if the formal system of land registration is to be maintained in a credible manner.

Government has been phasing in the removal of transaction taxes because the overly-high charges were having a disproportionate impact on low-income first-time home buyers. Over time the trend appears to be one of government reducing transfer duties for the low-income market, mainly first-time home buyers (i.e. for houses costing less than R500,000) attempting to move up the ladder into the formal property market. As the price of land and housing continues to escalate, government appears committed to continually adjusting its cut-off point upwards to ensure that fees are not a hindrance to people moving into the formal market. While calls have been made for the value of the house to be raised to R1 million, government did not heed this call in its recently released budget.

LAND DISPOSAL REQUIREMENTS

Concern has been raised from a number of quarters with respect to the costly requirements in the Municipal Finance Management Act 56 of 2003 (MFMA) that apply to the disposal by a municipality, or municipal entity, of capital assets no longer needed, which includes land. A municipality may transfer ownership of land, but only after the municipal council has considered a fair market value of the asset and the economic and community value to be received in exchange for the asset. Moreover, any transfer of ownership of such land, must be carried out in a fair, equitable,

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[11] Valuation fees are typically 0.1% of the property value.

[12] The Department of Land Affairs has taken the view that land reform beneficiaries should be exempted from transfer duty and this is currently the case. Moreover, the DLA is of the view that subsidies for land purchases should be zero-rated for VAT, similar to housing subsidies. While this was the case for a period of time, in 2005 SARS directed that the zero-rating should fall away. The DLA is currently negotiating with National Treasury to have this status reinstated (Interview Govender, DLA, 2007).

transparent and competitive manner. In addition, the Public Finance Management Act 1 of 1999 (PFMA) requires accounting authorities for public entities to manage and safeguard the assets of a public entity, comply with pension commitments and so on.

In particular, the argument is made that one of the reasons why municipal land is no longer available for low-income housing is because local authorities are required by law to put council-owned land up for sale on the open market, inevitably meaning it will be bought by the highest bidder. Whereas in the past, a fair amount of land that went into low-cost housing was a gift from a municipality or other sphere of government, this seems to be less the case now, particularly as the value of land has escalated so dramatically in recent years.

Hence, while on the one hand the requirements ensure municipalities receive fair value for their land, at the same time they face an imperative to ensure that they are able to address their need for well located land for the poor, and so legal opinion is often sought on the application of the legislation[13]. Some municipalities are finding ways around these constraints, generally by signing land availability agreements (rather than selling the land). This is discussed further in Section 4.

In October 2007 the City of Cape Town announced that the council intended selling upwards of R100 million of unwanted land it owned. A formal process was announced to identify, investigate and sell excess land through tenders in a strategic manner. This was to be the first time the council had entered the market on a competitive basis, as the previous council did not have a policy to do so. The intention was to ring-fence part of the proceeds from the sale and plough it back into infrastructure development, as well as to use it for priority projects (Business Day, 12 October 2007; Interview Davidson, 2008).

When examining the issue of land disposal, it clearly emerges that government is being torn between two contradictory imperatives. On the one hand, the Constitution requires that government operates in an accountable, efficient, equitable and transparent manner. On the other hand, legislation dictates that land is alienated at a market-related price. At the same time government is required to house the poor. As a result it is constantly in search of land at an affordable price. The issue is one of balancing these conflicts, or even prioritising where necessary, rather than sacrificing one set of imperatives for another. For now, local governments are seeking legal

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[13] Social housing associations, in particular, are in need of affordable land and so the National Social Housing Task Team (NSHTT) is currently holding meetings with National Treasury with the aim of finding less costly options for land release that are still in line with the MFMA (Interview Crofton, SHF, 2007).

opinions that will justify their releasing of land in ways that will meet their socially-related imperatives (Interview, Davidson and Odendal, 2008).

3.3.2. LAND PLANNING AND DEVELOPMENT

The White Paper calls for a national planning framework that would be able to override the old apartheid planning system and provide a new land-use management system for the country. It therefore argues that there should be one national law to deal with land use and development rather than a plethora of provincial ordinances, as is currently the case. A Land Use Management Bill (2000) has therefore been proposed to serve as that one law, which practitioners believe will go some way towards streamlining land management processes. Unfortunately this Bill has been bogged down within its department for a number of years[14]. In the meantime, the following regulations characterise the urban planning process.

SPATIAL DEVELOPMENT FRAMEWORKS

Since 1994, government has adopted a range of measures to deal with the spatial inequalities of apartheid. Cabinet adopted the National Spatial Development Perspective as an indicative framework to inform decisions on infrastructure provision. All tiers of government are expected to formulate these frameworks, which are aimed at finding a solution to the problems of integration and to guide infrastructure delivery throughout the country. Ultimately, the intention is that, starting from the bottom, planning frameworks will fit into the framework directly above them. The move to align frameworks is necessary in order to coordinate delivery timeframes and budgets, although the extent to which these frameworks are in fact aligned is unclear.

TOWNSHIP ESTABLISHMENT PROCESSES

In order to develop undeveloped land, it is necessary to engage with township establishment processes, land development area procedures and environmental regulations. More specifically, developers must seek approval for applications to carry out development, including residential, commercial and industrial. Municipal zoning regulations are used to set restrictions on what property may be used for, e.g. manufacturing, conducting a business, constructing housing, operating a municipal function and so on. In this way, local authorities control the use of space i.e. the rights associated with each piece of land.

[14] The Land Use Management Bill is discussed in more detail in Appendix B.

Historically, each province has had its own set of ordinances to set the regulatory environment for carrying out development in the (former) white areas. With the removal of the apartheid restrictions, new legislation was required to by-pass the ordinances and fast-track development. During this same period there has been a strong desire to do away with the ordinances completely and replace them with the previously described proposed national Land Use Management Bill, as a means of bringing a degree of much needed uniformity to the system.

For now, and until the proposed Land Use Management Bill is passed, developers may pursue any one of three routes in carrying out township establishment, i.e. they must either use one of the existing provincial ordinances or use either of the two relatively new pieces of legislation:

- National government’s Less Formal Township Establishment Act (No 113 of 1991) (LEFTE)
- National government’s Development Facilitation Act (No 67 of 1995) (DFA)

These pieces of legislation are briefly outlined below.

LEFTE Act (No 113 of 1991)

LEFTE (1991) was intended to shorten procedures for designating and developing land for low-cost housing delivery and the establishment of townships, less formal forms of residential settlement, and the use of land by tribal communities for communal forms of residential settlement. The Act was amended in 2006 to make provision for withdrawing an area that had been designated for less formal residential settlement, but was ultimately found to be inappropriate for such delivery (Interview Thatcher, 2007).

Development Facilitation Act (No 67 of 1995)

The DFA was formulated to rapidly redress the previous denial of urban land rights to black people. It was intended as an interim measure, which could deal with the legal uncertainty of land ownership in certain parts of the country, as well as fast-track RDP housing projects, which were necessary at the time.

More specifically, the DFA was seen as being able to provide nationally uniform norms and standards in relation to land development through national legislation, which would operate in parallel to the inherited provincial ordinances, and therefore act as an alternative mechanism for rapid land delivery in the face of delays at a local government level. Most importantly, the DFA imposed time limits on its processes, allowing for a greater degree of predictability for developers.

Looking back over this period the question is, how well has the DFA been able to perform? The answer to this question lies in the fact that while in theory developers are free to choose the route to use in carrying out township establishment, in practice there will be mitigating factors that will influence their choice. For example, some provinces, e.g. the Western Cape, have never established the prescribed Development Tribunal necessary to adjudicate developer's applications. Some cities, Johannesburg for example, are unwilling to accept decisions regarding applications coming from a higher tier of government, which is the correct procedure to follow when developers pursue the DFA route. The confusion, which results from having these various options, often manifests as delays in the approval process and therefore added costs to developers, who respond by undertaking less development than they might otherwise, while others may exit the market entirely as costs and uncertainty escalate.

An interview with the mayor and senior officials of the City of Cape Town elicited the view of how frustrating the Ordinance route is, as the Cape does not have a tribunal of its own, and that they would be keen to see developers empowered to use the DFA route due to its imposition of timeframes on the decision-making processes (Interview, City of Cape Town, 2008).

Recently developers have taken the Johannesburg City Council to court because of a decision it took in August 2006, in which it refused to recognize approvals from the Gauteng Development Tribunal. The Tribunal had been used by the developers to by-pass the city's planning department, which they claimed was in a shambles and whose slow approval processes added to their development costs. Moreover, the developers argued that the DFA legislation sets down time-frames in which applications must be heard and acted on, as compared to the city council approval process, which has increased time-wise significantly over the past few years, again leading to a prohibitive escalation of costs.

The court ruled against the Council's objection to the Tribunal's jurisdiction arguing that the DFA empowers tribunals to take decisions on behalf of municipalities. The City of Johannesburg, on the other hand, argued that the two parallel systems create confusion and make the approval system untenable. The City noted its intention to lodge an application for leave to appeal

(The Star, 8 February 2008).

In sum, it is clearly the case that the township establishment and approval processes are fundamental to ensuring the property market operates efficiently. Many cities are experiencing a lack of zoned land for residential, commercial or industrial purposes. Moreover, a range of conflicting processes, and the lack of skills in municipalities and provinces to implement processes in a timely manner, are resulting in development costs significantly increasing over time. At the very minimum, developers are looking to government to come up with a means to limit their risks and costs rather than add to them.

INTEGRATED DEVELOPMENT PLANS (IDPS)

The IDP is an important determinant of land use within the boundaries of a municipal authority. The Municipal Systems Act (No. 32 of 2000), requires municipalities to prepare IDPs for five-year periods. The intention is to provide a mechanism for implementing Land Development Objectives and ensuring that physical delivery is tied to appropriate planning, financial and institutional frameworks.

The Act's regulations require every IDP by law to include a spatial development framework, including at least *basic guidelines for land-use management by the municipality*. For example, while spatial development frameworks are not statutory they are used by planners to impel e.g. urban edges, which can end up being fairly inflexible guidelines as to how a city expands (Interview, Davidson and Odendal, 2008). The intention of the IDPs has been extended even further with the recent requirement for municipalities to formulate a Housing Sector Plan, which is described later in this section.

Local authorities, many with limited planning capability, have struggled over the past few years to prepare IDPs, although most seem to have met the minimal requirement of formulating an IDP. It is the quality of the plans, however, which is highly suspect as in many instances they can be quite simplistic and limited in scope, with little or no guidance on current or future land use.

Cities, e.g. Cape Town, view the IDP as a means of planning infrastructure investment in a way that guides future development, while balancing the interests of those living in the city. However, while the IDP should be used to set the overall direction for future development, frustration arises due to the difficulties in persuading line departments to inculcate municipalities' IDP goals into their own operations and act cooperatively (Interview, City of Cape Town, 2008). One of government's key challenges therefore lies in the realm of intergovernmental relations, which requires government to operate in a coordinated manner, if it is going to align delivery programmes, timeframes and budgets.

3.3.3. SUMMARY: MARKET IMPACT OF LAND ADMINISTRATION AND DEVELOPMENT POLICY AND LEGISLATION

In sum, there is a plethora of legislation which governs land administration and planning, the implementation of which occurs across various spheres and tiers of government. While the land administration system is basically procedurally sound, township establishment and the issuing of title deeds are not keeping pace with the increasing demand for land and housing, in particular at the low-end of the housing market where large numbers of government-subsidised housing has been delivered. This is leading to a growing frustration from developers who operate at this end of the market.

Nor is there sufficient land being zoned for industrial, commercial and residential use. These slow-downs in efficiency are becoming serious issues over time and are significantly adding to developer costs. Other government imperatives, e.g. the need to protect both the environment and places of historical interest (discussed later in this section), are having significant impacts on the land market, and often result in conflicting goals. Government would serve everyone's interests by deciding what its absolute priorities are (for example, economic growth and job creation) and then taking steps to ensure that lesser priorities, and their associated procedures, do not continually interfere with meeting its primary goals.

Moreover, since 1994 there has been a real attempt to speed up traditional planning processes by passing so-called fast-track (DFA) legislation. However, because old legislation still remains and not all of the systems are in place to implement the new legislation, confusion reigns. Developers attempt to second-guess the process by trying to figure out which development route will be the easiest and less costly for them to pursue. This is clearly not the best framework for developers to operate in, resulting in confusion, conflict and delay. Both the public and private sector will benefit from a uniform national, streamlined framework.

Government's intention, therefore, to address a complicated and overlapping land planning situation through a proposal to have one over-arching land-use management law, makes sense. Unfortunately it has been bureaucratically bogged down for a number of years, allowing other tiers of government to fill the gap. Nevertheless, President Mbeki, similar to previous years, in his annual State of the Nation speech in February 2008 noted government's intention to address several weaknesses, including the processing of the Land Use Management Bill, which is probably why the Bill has finally come before Parliament (The Weekender, 9 – 10 February 2008). Such a move will be welcomed, if indeed it does occur.

Finally, government appears to be viewing its planning exercises much more intently as a vehicle for exercising its political imperatives around integration, rather than focusing on ensuring the efficient functioning of the market. Where in the past municipalities have been required to produce land-use guidelines, government is moving towards a more prescriptive approach that aligns and coordinates plans and budgets. Planning exercises are intended to become participative, in that they are expected to engage communities around their needs for land, housing and amenities. One of the reasons for this is so that development is no longer perceived as simply reflecting the needs of the better-off segments of society. Municipal councils that are able to balance the needs of different segments of their society will end up better able to meet their political, economic and social goals. How land is apportioned to the various segments of society is fundamental to this goal.

3.4. POLICY AND LEGISLATIVE FRAMEWORK: HOUSING DELIVERY AND URBAN DEVELOPMENT

While the focus of this exercise is not on housing *per se*, it is clearly the case that due to the scale of government's imperatives around low-cost housing, the policies this engenders have the potential to impact on the operations of the property market. Most importantly, these policies have required that government becomes involved in the market on a number of levels, and not just as the arbitrator and creator of the rules which govern it. This section therefore briefly outlines the institutional framework and draws some conclusions on its effect on urban land markets.

3.4.1. NATIONAL HOUSING POLICY: 1994 - 2004

Government's housing policy was set out in the 1994 Housing *White Paper.* The *White Paper*, more than any other document, defines the overall approach to carrying out housing delivery, which crucially sees *facilitating the speedy delivery of land as one of its eight key strategies.* Efficient assembly and release of appropriately located land for housing was viewed as critical to achieving the desired rate of housing delivery.

At the same time, the *White Paper* paid little attention to municipal participation in the delivery of housing. Rather, housing delivery was to be driven by the private sector. The private sector would therefore be responsible for sourcing the land it required for the delivery of RDP housing projects[15]. In looking back over the past fourteen years it is clearly the case that the Housing Subsidy Programme was fundamental to providing poor people with the opportunity to access urban land and acquire an asset. However, housing beneficiaries' unhappiness with issues such as the quality of the housing unit and, in particular, the location of the housing projects, resulted in the Housing Act (No 107 of 1997).

The promulgation of the Housing Act enacted the housing policy framework as set out in the *White Paper.* The Act describes the nature and manner of residential settlement development and therefore expresses a view as to how land should be acquired for housing purposes, specifying that, as part of a municipality's IDP, land is identified and designated for housing development.

Clearly, government[16] viewed this Act as a way to direct where housing delivery would occur in the country and to ensure that it began to fulfil the goal of integration. As a means of giving effect to this goal, the housing sector has recently extended its IDP process to include a *Housing Sector Plan*.

In May 2004, the President in his State of the Nation address referred to a "comprehensive (housing) programme dealing with human settlement" and the need to address the "broader question of spatial settlement patterns". The highlighting of this theme was more than likely because of the unhappiness with the *location* of the delivery that occurred in the first 10 years. Both quality and location issues led to a

[15] In the first years of delivery much of the land the private sector used was land that had been previously banked by developers in anticipation of the new policy.

[16] Government also formulated an Urban Development Strategy (1995) to propose strategic interventions aimed at improving spatial inefficiencies through infrastructure investment and an Urban Development Framework (1997), which set out a vision for urban areas.

revisiting of the housing policy and the preparation of a new Plan, entitled *Breaking New Ground.*

Hence, following on the heels of the shifting of the responsibility for the driving of housing delivery away from the private sector to municipalities, the housing policy has become far more complex in terms of what it sets out to achieve. The recently revamped housing policy, as put forward in the 2004 Plan, *Breaking New Ground: A comprehensive plan for the development of sustainable human settlements* (BNG), requires a fundamental shift away from simply delivering RDP housing to the delivery of 'sustainable human settlements'[17].

Human settlements are viewed as requiring more than the random acquisition of land. Sustainable human settlements are looked to as a means of delivering a mix of usages, including residential, commercial and social amenities as well as a variety of housing typologies. Importantly, the procedures for formulating future projects and plans require adhering to strategic planning processes that incorporate local people's views into the outcome.

Noteworthy is the fact that a thorough reading of *BNG* reveals it to be a very comprehensive list for government in terms of what it needs to do and where it needs to intervene in order to move forward with its desire to integrate the country spatially and ensure that delivery occurs in an 'inclusionary' manner. Rather than being a policy document as such, it is (in government's words) a plan being proposed.

In monitoring the implementation of *BNG,* the key issue is whether the policies proposed in the plan will be able to address its stated aims, or whether they end up negatively affecting the rate of housing delivery due to the complexity of the processes envisaged.

3.4.2. GOVERNMENT FUNDING ARRANGEMENTS FOR HOUSING & LAND ACQUISITION

The scarcity of suitable land, which is fundamental to being able to better locate delivery and spatially integrate urban areas, has to a large degree resulted from its enormous escalation in price over the past few years. This has forced government to

[17] 'Sustainable human settlements' refers to meeting the "needs and circumstances of communities through a diversified range of support measures which are able to accommodate qualification and affordability variations, tenure preferences and investment priorities. There is also a need to stimulate the supply of a more diverse set of housing environments and settlement types through greater choice of housing types, densities, locations, tenure options, housing credit and delivery routes (e.g. self-help, contractor-supplied, etc.)" (BNG, 2004).

re-think how it contemplates expenditure on land acquisition, which is reflected in its budgeting over the next few years.

One of the significant aspects of the new housing plan is the rate at which housing expenditure is expected to accelerate over the next few years. Total expenditure more than doubles from R4,2 billion in 2002/03 to R9,5 billion in 2008/09. The average growth rate of 7.7 percent between 2002/03 and 2005/06 is set to accelerate to 21.5 percent from 2005/06 to 2008/09[18] (RSA National Treasury, 2006).

Government, with its latest budget, is starting to put its money where its mouth is. In future, funding for land acquisition is to be a cost which the poor will not be expected to bear. Rather it is to be viewed as a broader social cost which government must fund independently from the current housing subsidy. Government has therefore taken a decision that it will subsidise the cost of land at its market-related rate, through a separate funding mechanism, which will be accessed through the provinces. During 2007, the housing subsidy was therefore stripped of the land component. Moreover, a measurable output in terms of the Housing and Human Settlement Grant will now be the number of hectares of state land acquired or private land purchased for housing development. The state therefore plans to become an even more active and prominent player in the land market, acquiring well located land at market prices.

As a first point of call, municipalities without significant land holdings of their own are looking to the public sector to put unused land up for sale, which they could purchase for housing purposes. At this point in time, however, there is a voluntary moratorium on public land sales. Moreover, parastatals have been directed to carry out audits of land they are not using[19]. Some land sales, however, can take place. Propnet[20], for example, can apply to the Minister of Transport to sell properties which are not core assets from time to time. In this situation it must give the national Department of Housing and other government departments the right of first refusal before going onto the open market, although it should be noted that a market-related price for the land is normally paid by the DoH. Noteworthy is the fact that land put onto the market by government departments will often carry with it a zoning restriction or a development

[18] More specifically, housing delivery is funded out of the Integrated Housing and Human Settlement Development Grant, which is allocated through the Division of Revenue Act (No 2 of 2006). The conditional grant enables the national government to provide for the implementation of housing delivery by provinces and (soon-to-be) accredited local authorities. Currently the national department has the authority to provide conditional grants to provinces and (again, when they are established) accredited local authorities in terms of the Medium-Term Expenditure Framework (MTEF), which requires departments to put forward their priorities for 3-year cycles[18].

[19] It is unclear how far along these audits are.

[20] Propnet is justifying the selling of its non-core assets as necessary to fund its enormous Capex programme (Interview, da Silva, 2008).

prescription aimed at ensuring a social imperative (Interview, da Silva, 2008). This is to prevent land which is being transferred for low-cost housing being used for commercial developments.

3.4.3. NEW PROGRAMMES AIMED AT INTEGRATING URBAN AREAS

This section attempts to describe a number of new policies and programmes aimed at integrating urban areas. Some have arisen from the housing sector and *BNG,* others from National Treasury. Some, for example the Urban Development Zone tax incentives, are currently being implemented while others, such as the Social Housing Policy, are simply at the level of policy formulation and are awaiting legislation to be passed to give them effect. In the case of the proposal for preparing a Housing Chapter of the IDP, the policy has been agreed to and is currently being rolled-out across the country.

THE NEW HOUSING CHAPTER OF THE IDP: HOUSING SECTOR PLAN

BNG emphasises demand-responsiveness[21] on the part of government as the means for determining future housing delivery. This is in contrast to the supply-driven housing delivery that occurred in the first ten years of the new policy. In order to ensure that a participative planning process is carried out, the DoH has developed a guide for municipalities to carry out planning around housing demand and then to integrate this work into the municipalities' IDP process. The national DoH's Programme for Housing Chapters of IDPs is therefore intended to provide a clear framework for incorporating planning for housing delivery into the municipal[22] IDP process[23]. The DoH has embarked on a five-year roll-out strategy in order to link the formulation of a Housing Sector Plan to a municipality's IDP cycle, with R450 000 being made available for the formulation of the plans. Ultimately, six metropolitan municipalities, 231 local municipalities and 47 district municipalities will compile housing chapters[24] for their IDPs, with the expressed intent of better locating housing delivery (DoH, Annexure A; DoH, Submission to MinMec, April 2006; DoH, MinMec, May 2006). One advantage of this process is that it will bring a certain degree of predictability to local markets, as municipalities will be planning ahead for housing delivery.

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[21] Demand-responsive development is defined as the determining of development priorities, using local government processes, which establish the needs of households through consultation.

[22] The Programme for Housing Chapters of IDPs applies equally to accredited and non-accredited municipalities.

[23] The Intergovernmental Relations Act (No 13 of 2005) is intended to ensure that priorities set at the municipal level are agreed to on up the tiers of government. Intergovernmental forums, which are prescribed in the Act are intended to result in *signed-off agreed to protocols* identifying, e.g. the roles and responsibilities of each organ of state, priorities and desired outcomes, indicators, oversight mechanisms, required resources and so on.

NATIONAL PROGRAMME: UPGRADING INFORMAL SETTLEMENTS

Another policy with the potential to affect the urban land market is the relatively recent Upgrading of Informal Settlement Policy. *Breaking New Ground* (2004) sets out a fundamental shift in housing policy on the approach to informal settlements, compared to the 1994 *White Paper.* That is, it focuses on the upgrading of informal settlement as opposed to removing people living illegally in shacks to new greenfield developments. This change in approach arose from the fact that local authorities are simply unable to source sufficient amounts of land on which to resettle their housing backlogs. Moreover, the land on which people are currently informally residing is often far better located than that which the government would be able to afford to move them to.

Since more than 90 percent of low-cost housing delivery ends up being informal settlement upgrading, this policy shift means that less land will be required than was previously the case when greenfield developments occurred. Rather than requiring vast amounts of new land, which would be necessary to relocate nearly 2 million shack dwellers, land will only be required to de-densify overcrowded areas. This is still a significant amount, but not nearly as vast as what was required prior to the shift. For example, Cape Town will require 1 300 hectares of land at a cost of around R1.3 billion to merely de-densify its settlements by 30 percent (Interview, Davidson and Odendal, 2008).

THE SOCIAL HOUSING PROGRAMME AND URBAN RESTRUCTURING ZONES (URZS)

In 2001, the State President announced government's commitment to the regeneration of the inner cities of South Africa and the intention to broaden the current housing assistance programme to accommodate higher-density development and address the increasing demand for rental housing in urban areas (Social Housing Policy, 2005). As land, as previously described, is fast becoming a scarce resource, increasing densities would appear to be an entirely rational approach to future development.

Arising out of a review, a new Social Housing Policy was formulated and approved by MINMEC in 2005. Among its major features are the following:

- the idea of focusing social housing investment in designated *restructuring zones which will include both upper and lower income areas*; and
- the introduction of substantial capital grants as an add-on to the institutional subsidy.

The forthcoming legislation is intended to overcome the problems that have been experienced to date when there is an attempt to house lower-income households in higher-income neighbourhoods, i.e. the NIMBY (not-in-my-backyard) effect. This new policy therefore has the potential to provide a breakthrough in integrating further-afield urban areas, which, to date, have remained untouched (Interview, Crofton, 2007).

Key to the success of the project is the amount of money made available by National Treasury for the new National Restructuring Capital Grant[25], a sum of money way beyond the current Institutional Subsidy[26] which has funded social housing delivery to date (Interview, Crofton, 2007). The amount of money available for the grant is key to determining the scale this new policy will address. While the intention is to use the new URZ instrument to increase the scale of delivery of social housing, it is unlikely that it will have much of an impact on land markets because of the degree of subsidisation required by government to deliver this housing option. Only if the National Treasury decides to make a massive investment in this policy over a number of years will it be able to deliver at any kind of scale. However, as land on the urban edge becomes increasingly scarce and costly, government may decide that it will have to pursue densification more assiduously and therefore direct much more funding than has been the case to date towards the inner-cities.

3.4.4. URBAN DEVELOPMENT ZONES (UDZ)

Prior to the social housing sector proposing the new Urban Restructuring Zones, government in a bid to reverse economic decline in South Africa's cities had adopted a method of intervening in the cities through the introduction of economic and fiscal incentives. The Minister of Finance announced the promulgation of the Urban Renewal Tax Incentives in 2003 to facilitate inner-city renewal throughout South Africa by attracting private sector investment in construction, extensions, additions and improvements or refurbishment of buildings in designated Urban Development Zones (UDZ). The incentive differentiates between new building construction and refurbishment of existing buildings (www.treasury.gov.za). The incentive takes the form of an accelerated depreciation allowance, which results in a tax break for the developer. This does mean however that smaller developers, who tend to pay no tax or declare no taxes, cannot use this incentive.

[25] The Interim Social Housing Project is budgeted for over the next 3 years in government's Medium Term Expenditure Framework (R110 million – 2006/07; R180 million – 2007/08; R250 million – 2008/09) (Republic of South Africa, National Treasury, 2006). It is expected to deliver 110 000 units over the next four years; a per unit cost for the 2006 grant was R60 400 (Interview, Crofton, 2007).

[26] The quantum amount for the Institutional Subsidy for 2007 – 2008 is R38 984.00 (DoH, 2007).

In order to implement such zones, the municipality must have demarcated the area by formal resolution by June 30 2004, or such later date as the Minister may approve. Noteworthy is the fact that the demarcated area must be consistent with the municipality's IDP. In order to be demarcated it must be demonstrated that the area previously contributed the largest portion of the total revenue (i.e. rates and taxes) for the municipal area, but now the level of contribution has become a declining trend, demonstrating a high degree of urban decay relative to other parts of the city. In other words, this tax incentive is aimed at those South African cities that have been experiencing decay over a period of time, most noticeably Johannesburg.

In order to receive National Treasury approval for a demarcated area, each municipality must provide additional financial measures to support and enhance regeneration of its UDZ. These measures can take a variety of forms, including reduced property rates and local user charges. Moreover, each municipality must commit to the objective of processing all planning approval applications in the demarcated area within 90 days of submission and to providing National Treasury with regular reports of cases where this period was exceeded.

Firstly, in examining the impact of the UDZs, this is a comparatively simple intervention to access for anyone wishing to act as a developer in the inner city, as it simply relies on government demarcating an area and the eligible taxpayer then applying for the depreciation allowance. Moreover, because it is a tax incentive it does not appear to attract the plethora of administrative/bureaucratic problems that manifest when the private sector needs to engage with the public sector, e.g. around zoning applications.

Second, in a very short period of time it appears that where these zones have been demarcated it is visibly the case that developers have taken advantage of the allowance, e.g. in Johannesburg and Durban with investments of R3bn and R1bn respectively. The type of development being carried out, i.e. refurbishment or building construction, does seem, however, to arise from the differences in costing out the two options and opting for the one which appears to attract the more favourable tax concession.

More specifically, in the case of refurbishments, it appears that the land and building are almost 70 percent of the cost of the entire project, leaving a mere 30 percent as the cost of the actual refurbishments. In the case of a conversion, it appears that the land and building are only 30 percent of the cost of the project, while the conversion is closer to 70 percent of the cost of the project[27]. Hence the incentive is more useful

[27] Incentive is more useful for conversions than refurbishments.

if it is applied to conversions rather than refurbishments (Interview, Jackson & Webb, 2007).

Moreover, it would appear that the incentive is more useful to large developers than smaller developers who minimise the tax they pay up-front and so are less inclined to use such an incentive. Anecdotal evidence suggests that small developers, e.g. small, medium and micro enterprises (SMMEs), are unable to gain a benefit from the incentive. Finally, a significant limitation to the potential impact of this incentive is that it does not apply to section 21 companies and agencies which are not bound by standard tax provisions, and which therefore are not incentivised to the same extent as their private sector counterparts.

Business Day (15 October 2007), in an article focusing on the inner city, states that, “the success of inner-city regeneration in major cities such as Johannesburg is reaping healthy returns for investors, particularly in the conversion and refurbishment of residential buildings, which are breathing new life into former decaying urban areas”. Sarah Webb, Operations Manager of the Trust for Urban Housing Finance (TUHF), in the same article agrees that conversions and refurbishments in the inner city are a sound investment, “although it is not as opportunistic as a year ago, due to factors such as the significant increase in inner-city property prices, interest rate hikes and building cost increases.” Moreover, while up to a year ago residential conversions were considered the highest value and best use of property, today the commercial market is moving in this direction. And, as conversions begin to have an impact on the amount of space available for commercial use, vacancies appear to be dropping.

While Johannesburg and Durban have seen significant investment unlocked by this incentive, Cape Town, it would appear, has not seen a similar amount of uptake. This may be because, contrary to Johannesburg, where a massive deterioration had occurred, Cape Town’s inner city never suffered from a similar fate. Hence, there is not the vast quantity of non-performing stock in Cape Town as seen in other cities (Interview, Russell, 2008; Interview, Davidson, 2008).

The UDZ can also be used in innovative ways, such as in Durban where the zone was specifically positioned to allow private sector corporations to develop new offices which were slightly out of the traditional CBD but not as far north as the decentralised business node of Umhlanga. In this way the council managed to slow down the flight of large companies from the CBD area (Interview, Ndlovu & Masson, 2008).

Importantly, the legislation under which the incentive operates was due to expire in 2009. However, in the 2008/09 Budget Speech, the Minister of Finance announced a five-year extension of the incentive. Government obviously is of the view that the incentive is having a positive impact on regenerating inner cities and should therefore be continued. Government should continually assess its impact in order to refine the incentive as a response, to the degree that developers are finding it useful, and canvass the views of developers as to how the incentive can be made more efficient over time. Section four discusses the principle of incentives in more detail.

3.4.5. SUMMARY

Housing delivery and urban development has taken on a new strategic meaning in the Department of Housing's 2004 policy *Breaking New Ground*, the aim of which is to deliver sustainable human settlements rather than simply RDP housing units. Participative and coordinated planning exercises are becoming the tool through which to guide municipality's strategic decisions. These exercises are expected to result in more spatially integrated urban areas, and therefore better-located housing delivery. At the same time, this much more complex approach to housing delivery relies on the implementation of a package of policy and legislative prescriptions spread across different spheres and tiers of government. These policies and legislation are not all currently in place as they are coming into effect at different times, resulting in implementation problems. Moreover, when it comes to implementing its vision of how spatial planning should occur, government is rolling out capacity-building exercises to ensure that the provincial and local government officials, including both housing and planning officials, are empowered to carry out these exercises. It will therefore be some time before it is clear as to whether such planning exercises are having the intended effect.

What sort of impact will the new planning approaches and interventions have on the property market? Historically and within the structures of standard zoning prescriptions, the urban land market has operated according to conventional demand/supply principles, whereby its allocation has been determined by the 'highest bidder'. In future, municipalities are expected to not simply take these economic considerations into account but also to address government's imperatives of social integration and densification when it comes to both selling public sector owned land or granting development rights. Although it is unclear how this approach will manifest itself in practice, there is an obvious danger that interventions which entirely ignore or cut across market preferences will result in outcomes which are both inefficient (in terms of the appropriate use of land) and sub-optimal in terms of maximising the impact of public investments on the needs of poor households.

As we have seen, prevailing legislation can be quite contradictory and therefore onerous in its application to the planning and development function. Contradiction and confusion, especially around land alienation and land usage, must be addressed as the current situation makes the property market an uncertain and expensive space for investors to operate in. If not addressed, it will result in private developers and related players exiting these markets for sectors which are associated with lower direct and indirect transactions costs.

When it comes to municipalities purchasing land to address infrastructure and housing backlogs, national government seems to have adopted the view that it will have to provide significant additional resources to local governments in order for them to become more prominent participants in the land market, for now, at a market-related rate. This commitment is reflected in its budgets, which are set to increase significantly over the next few years. As the state becomes a prominent purchaser of land for its own housing developments, in the face of a finite amount of zoned land, this is likely to place upward pressure on land prices. Given current shortages in the affordable housing market, it is unlikely that developers will then be able to compete in this price band, and will instead concentrate on the upper end of the market where margins are higher.

What impact this will have on the property market generally remains to be seen, but will in large measure depend on how market-compatible the state's policies and interventions are.

3.5. OTHER RELEVANT LEGISLATION

Whilst the policy and legislation discussed above are promulgated specifically to deal with land issues, there is a proliferation of other legislation which impacts on the urban property market. This legislation is often well justified in its aims, however its lack of alignment with other policies and ineffective application can lead to unintended consequences which undermine the operation of the land market. The following section briefly touches on some of the main pieces of legislation affecting the urban land market.

3.5.1. ENVIRONMENTAL CONSERVATION ACT (NO 73 OF 1989 – AS AMENDED BY ACT 79 OF 1992)

The theme of integration has also been picked up and carried through in environmental legislation. In order to carry out new land development, environmental impact assessments (EIAs) are required on all land offered for development in response to a land availability call from a municipality[28].

Over time there has tended to be an outcry by developers and municipalities over the fact that the EIAs are interfering with the pace of development. It is not simply the provincial approval, which takes a lengthy period of time to receive, but a range of other stakeholder approvals, which add significantly to the waiting period. Most frustrating is that commitments to any kind of time limits are not forthcoming, and applications can take up to three years to be approved. This adds to uncertainty around the developmental process, as environmental approval is a prerequisite for a range of other approvals from municipalities – which in turn is a protracted process. It is understood that a new set of regulations will shortly be introduced to speed up the approval process.

In addition, EIAs can get in the way of government's development imperatives. For example, the City of Cape Town has huge land holdings around the airport. Many people are already housing themselves informally in this area and the City is keen to use its land for low-cost housing purposes. However, because of flight patterns the land is viewed as too noisy for formal human occupation. This is a clear case where a regulatory consideration directly undermines the ability of government, whether directly or through a market delivery mechanism, to meet the needs of the poor. A clear and agreed hierarchy of priorities which reflects alignment of the different tiers and spheres of government is a prerequisite for the creation of an enabling delivery framework, rather than one which detracts from effective delivery. It would appear that most people, including developers, are becoming more accepting of the view that the environment needs to be protected. At the same time it would appear that a situation, similar to what prevails with the PFMA and MFMA, has arisen in that the environmental prescriptions often find government pursuing two conflicting imperatives, that is, the need to protect the environment while ensuring sufficient economic growth and service provision to address the historical backlogs. Developers, in assessing where they want to invest in the land market, first and foremost seek clarity, efficiency and transparency on the part of government in pursuance of its goals (Interview, Russell, 2008).

3.5.2. NATIONAL HERITAGE RESOURCES ACT 25 OF 1999

The National Heritage Resources Act places development controls on formally protected properties (i.e. national heritage sites) as well as generally protected

[28] The Minister of Environmental Affairs and Tourism may grant an exemption from compliance with any or all of the provisions of the Act.

properties/areas. Development controls include those in sections 34 and 38 of the act. Section 34 states that “No person may alter or demolish any structure or part of a structure which is older than 60 years without a permit issued by the relevant provincial heritage resources authority.” The provisions in section 38 state that the responsible heritage resources authority must at the very earliest stages of initiating a development[29] be notified and furnished with details regarding the location, nature and extent of the proposed development. This control applies specifically to development activity on a site exceeding 5 000 m^2, involving three or more existing erven or subdivisions thereof, or such erven which have been consolidated in the past five years, as well as the re-zoning of a site exceeding 10 000 m^2.

Whilst these provisions may not immediately seem applicable to the land market, numerous developers raised delays and restrictions imposed by heritage authorities as a specific problem. The above provisions are strictly applied in Cape Town specifically, due to the fact that it is South Africa’s oldest formally planned city and is thus important to conserve. Cape Town’s history is written into how land was used over time, e.g. in District Six (Interview, Russell, 2008). The South African Heritage Resources Agency (SAHRA) has become very powerful in determining land usage in and around the city. Although this is an important consideration, it adds to the onerous and time-consuming procedures developers have to comply with, particularly in land-scarce urban locations.

EXPROPRIATION ACT NO. 63 OF 1975 AND ITS AMENDMENT

Currently the Expropriation Act states that “the Minister may, subject to an obligation to pay compensation, expropriate any property for public *purposes*…” This is a narrow concept which will be broadened to the public *interest* should the Expropriation Bill be passed. This represents a clear shift from the willing buyer willing seller policy previously adopted. Importantly for the urban land market, the amendments make mention of some relevant cases where expropriation may take place:

- To facilitate township development
- For land settlement (restitution)
- For land reform
- For security of land tenure

[29] A development includes “the construction of road, wall, powerline, pipeline, canal or other similar form of linear development or barrier exceeding 300 m in length; the construction of a bridge or similar structure exceeding 50 m in length”; as well as those types of developments mentioned in the text above. (National Heritage Resources Act, section 38)

'Public interest' is thus a broader concept which includes various activities that would be for a public purpose but not be included in the current phrase. The Bill might be interpreted as giving better effect to the objectives of the Constitution in both this respect and the issue around compensation. The payment is now to be "just and equitable reflecting an equitable balance between the public interest and the interests of those affected" – this will avoid the current possibility of paying higher compensation than that prescribed by the constitution. (Currently an owner may claim, in excess of the market value of the land, "an amount to make good for the actual financial loss caused by the expropriation" as well as a *solatium*[30].)

In the event of the Expropriation Bill being passed, it will, amongst other things, grant extended power to the Minister to expropriate land for the purpose of providing housing to the lower end of the market. How this will work in practice remains to be seen, although it is interesting to note that the draft Housing Development Agency Bill (B1 – 2008), discussed later, provides for the proposed Agency to expropriate land to fulfil Constitutional mandates around land and housing delivery (Republic of South Africa, HDA Bill, 2008).

One significant concern regarding this Act, beyond the discretionary power that the definition of 'public interest' confers to the Minister, is that it reinforces the perception, which may be gathering currency in official circles, that public interventions of this nature are the only basis for the delivery of housing at the lower end of the market. This perception is further enhanced if the regulatory environment is such that it deters or displaces private players from the market. Thus, instead of addressing the causes of the market's diminishing ability to deliver at these levels, the state adopts an increasingly interventionist stance, thereby setting in motion a self-perpetuating cycle of market displacement and distortion.

3.5.3. THE NATIONAL CREDIT ACT

The National Credit Act of 2005 affects the property market through its impact on demand from individual consumers. Applicants for mortgage finance must now complete an affordability assessment, which takes into account all expenditure, before the loan can be approved. This is to prevent reckless lending, and raises the possibility that even if a loan repayment amounts to less than the 'rule of thumb' 30% of monthly income, the application may be turned down. Any sentiment that the NCA has impacted negatively on the poor should be viewed cautiously, as the act is

[30] A *solatium* is defined as "compensation for injured feelings as distinct from financial loss or physical suffering." The current act prescribes specific amounts to be paid as as *solatiums*, in excess of the market value and compensation for financial loss.

constructed to prevent reckless lending. If the application of an individual who would previously have been offered a loan is now declined, this is more a reflection on the former lending practices of the institution than on the impact of the NCA.

3.5.4. PUBLIC PRIVATE SECTOR AGREEMENTS: CHARTERS

Both the Property Sector and Financial Sector Charters are worthy of mention, as they represent the private sector's engagement with the government in finding common ground to try and achieve government's stated policy goals of greater access to housing finance for historically excluded South Africans.

PROPERTY SECTOR CHARTER

The Property Sector Charter prescribes the implementation of broad-based black economic empowerment (BBBEE) in the property market – specifically with respect to ownership, control, and management of *enterprises* in the property sector. The Charter addresses the following areas and sets certain targets for the implementation of BBBEE in these areas: employment equity, skills development, procurement, enterprise development, ownership, control, property development and transformational infrastructure projects, corporate and social investment, as well as gender transformation. Whilst these will undoubtedly impact on the players in the market as discussed in section one, their relevance to the actual workings and outcomes of the property market will be minimal.

The Charter does make mention of property ownership by previously disadvantaged groups. To date, its commitment to unlocking obstacles that restrict the ability of black people to own property by, amongst other things, addressing the administrative and legal constraints to ownership, enhancing access to finance and meeting asset disposal targets, remains to be clearly substantiated.

FINANCIAL SECTOR CHARTER

The South African financial sector is also subject to financial inclusion regulation via the Financial Sector Charter, negotiated and signed by the private financial services sector in 2003[31]. The Charter is part of the move to enhance the process and content of black economic empowerment (BEE). It is a transformation charter as

[31] The parties to the negotiation were the formal financial institutions and their industry associations on the one hand, and the Association of Black Securities and Investment Professionals on the other. Although government was always in the background, they were not an active participant.

contemplated in the BBBEE Act, 53 of 2003, which is aimed at levelling the playing field skewed for decades by apartheid.

Though not directly part of the property market regulatory framework, the Charter impacts on the market through its target for mortgage finance. Banks in South Africa agreed to extend R42 billion worth of loans to LSM 1-5 before the end of 2008, a target which it is well on its way to achieving. Recent interest rate hikes and a lack of supply in the affordable housing market have however begun to impact on the financial sector's ability to find clients who can *afford* to take out a mortgage, despite the banks' willingness to extend credit to those who qualify. Interestingly, this has led to the acquisition or creation by banks of their own development arms, as they enter the property market themselves in order to increase the supply of affordable housing in order to extend mortgage finance to the charter market.

3.5.5. TENANT – LANDLORD RELATIONSHIP

The state is also active in regulating the relationship between tenants and landlords in rental arrangements. Largely motivated by farm evictions after the 1994 elections, the Prevention of Illegal Eviction from and Unlawful Occupation of Land (PIE) Act is now being used in urban areas to avoid eviction upon non-payment of rents. Its extension has significant potential implications for the future of the private rental market to the extent that it results in a distortion of the risk, reward and rights symmetry of the tenancy- rental relationship.

PREVENTION OF ILLEGAL EVICTION FROM AND UNLAWFUL OCCUPATION OF LAND (PIE) ACT, 1998[32]

The PIE act states that an unlawful occupier may only be evicted on the authority of a court after he/she has unlawfully occupied the building or piece of land for longer than six months. The court may then only grant an order of eviction after it has taken into account all relevant circumstances (which can be a multitude of things) and also *only after alternative accommodation or land* for the person being evicted has been made available. Thus, no-one may be evicted unless refuge for that person is provided.

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[32] NOTE: There is currently an amendment to this Act being introduced in parliament. Whilst this amendment is not analysed here, indications are that the PIE Act, should the amendments be passed, will not apply to people occupying land as "tenants, or in terms of any other agreement". This would have implications for the analysis above.

Landlords tend to argue that the act is heavily biased towards tenants. As discussed below, this has led to increased screening and controlling of tenants at the lower end of the market, as it can be extremely costly to evict a tenant who no longer pays their rent.

Screening of potential tenants

Whilst there is a need for the regulation of tenant-landlord relationships, there are indications that in South Africa this regulation is particularly onerous. Because it is so difficult to evict problem tenants, the emphasis has shifted to the screening of potential tenants prior to occupation. For example, applicants for one of Jozi Housing's 1 500 inner-city rental units have to undergo a screening process which includes income verification, employment verification and credit checks. The private sector has also set up an independent database called the Tenant Profiling Network, as it was found that a particular stratum of serial defaulters was not picked up by the credit bureau. Tenants with unpaid arrears of more than R300, as well as 'problem' tenants are listed on the database. All applicants are then screened against this database as well.

There are very good reasons for this screening. In one case, a tenant who stopped paying rent was only evicted after 18 months of legal wrangling. Jozi Housing incurred costs of more than R150 000 in legal fees and lost rentals during this time. Although the screening process is costly (and ultimately borne by tenants), it is money well spent if it can avoid the even heavier costs associated with evicting tenants.

RENTAL HOUSING ACT

This act mandates government to promote a stable and growing rental housing market to provide affordable rental housing for previously disadvantaged and poor individuals. Government is mandated to put incentives in place to improve conditions in this market, promote investment in it and correcting distorted patterns by initiating, facilitating and promoting new developments. Public-private partnerships are also encouraged.

The act allows for a rental housing subsidy to be introduced as a national housing programme, as well as the establishment of a Rental Housing Tribunal. Any tenant, landlord or interest group may lodge a complaint with the tribunal concerning an unfair practice. The tribunal has the power of a magistrates' court and may make rulings that are just and equitable to both tenants and landlords, although anecdotal evidence suggests that rulings tend to favour tenants, particularly in terms of punitive rental allegations. For example, rent increases in excess of 10% are generally seen as punitive even if the increase is market related and reflects a growing demand for the rental units.

All in all, the act attempts to facilitate the effective working of the rental housing sector by making provision for government to establish appropriate incentives and increase the accessibility of this market, as well as the introduction of the Rental Housing Tribunal to hear and make rulings on complaints related to unfair practices in the rental housing market. To date it appears as though government has not implemented any incentives for this programme, which is of concern given the potential impact of a well constructed incentive scheme for rental housing.

3.6. PROPOSED INTERVENTIONS AIMED AT INTEGRATION AND 'INCLUSION'

This section briefly looks at some of government's proposals around integration and 'inclusion' and starts to speculate as to the effect these could have on the land market. More important however, is the effect these proposals are currently having on the property market. Despite being prospective pieces of legislation, their possible impact is such that players in the market are already taking them into account in their current behavior and future planning.

3.6.1. 'INCLUSIONARY HOUSING'

After a number of years of putting policies in place to encourage integration, at some point government embraced the view that without more state intervention than has been the case to date, there is little prospect that market forces alone will change the current spatial landscape of South Africa. Thus, in spite of the drive to ensure that municipalities carry out IDP processes, develop spatial frameworks, strive to deliver sustainable human settlements, employ UDZs incentives and so on, more – and more prescriptive - intervention is considered necessary.

At the same time, government is increasingly concerned that effective demand for a housing unit costing more than the current housing subsidy of R38 400 but less than R200 000, stood at 75000, whereas only 16 000 units were supplied per year by the private sector from 2000 to 2004. It has concluded that of the main reasons for this lack of supply is the scarcity and high cost of well-located land[33].

When it comes to formulating interventions to improve this situation, there appears to be an understanding from both the private and public sectors that these interventions should be approached in such a way that they will not end up slowing down the already stagnating rate of production of new low-cost housing. More specifically, 2006 has been the worst year for delivery statistics, with only 158 918 units being delivered from September 2005/6. This figure is down from a high of 217 348 in 2004/2005 (FinMark Trust, *Access housing*, Jan, No 5, 2007; FinMark Trust, *Access housing,* July, No 7, 2007)[34]. So what options has government been looking at?

The 2004 plan, *Breaking New Ground* in Section 3.2 on Promoting Densification and Integration, called for a densification policy based on the creative use of policy and planning instruments, e.g. residential development permits. Such permits are often used overseas, and it was the success of this approach in countries such as Ireland and Malaysia that persuaded the Minister of Housing to propose in a letter to the media (*Business Day,* 18 Oct 2005) a target of 20 percent of new developments, based on either the 'monetary value of the development' or the 'value of the land', to be allocated to low-income housing, although not necessarily as part of the same development.

Hence, on 23 September 2005, the national Department of Housing and the private sector agreed[35] to a 'Social Contract for Rapid Housing Delivery'. The agreement committed both the public and private sector to work towards a common objective of ensuring the promotion of a non-racial, integrated society through the development of sustainable human settlements and quality housing. Over the past two years the South African Property Owners Association (SAPOA), as the representative body of the property sector, has been in negotiations with government on the formulation of an 'inclusionary' housing policy (Tomlinson & Emdon, 2006).

The extent to which government moves to adopt a policy on 'inclusionary' housing will only be clearly known if and when it decides to move forward in terms of drafting necessary legislation. That is, it is not yet clear whether such a policy would *influence, require or compel* the private sector to meet certain targets. Moreover, it is

[33] FinMark Trust in its September 2007 edition *of Access housing* describes how the price of a serviced stand has doubled from R46 000 to R93 000 during the period December 2003 – June 2006.

[34] Anecdotal evidence suggests that the significant slowing down in housing delivery is, in part, due to a break-down in local authority capacity.

[35] The Housing Indaba in Cape Town during 22 – 23 September was, in a sense, a replay of the 1994 Botshabelo Housing Accord, which also set out commitments by key housing stakeholders.

still too early to assess the impact of such a policy, e.g. how effective the various incentives it proposes to encourage developers to carry out such delivery would be in practice. It does seem clear however, that based on the experience of UDZs, incentives work better than prescriptions.

Noteworthy is the fact that an 'inclusionary' housing policy would be different from other government initiatives in that it would aim to increase the supply of 'affordable housing'[36] in *existing middle and upper-income* (mainly white) areas, as opposed to simply funding new low-cost housing developments on the urban periphery, as has been the case to date.

While it is clearly the case that certain cities have already changed their zoning restrictions to permit higher residential densities in suburbs than in the past, such changes have mainly resulted in homeowners sub-dividing their properties and building additional units, either for their own use or for rental, rather than as a mechanism to address the needs of the poor. That is, additional units are generally not intended for poorer households, but end up maintaining the middle and upper-income flavour of the neighbourhood they are located in.

The talk around inclusionary housing policy has begun to affect the property market, despite not yet existing in legislation. For example, the Western Cape provincial government took the decision to legislate on 'inclusionary' housing prior to national government finalising its own policy. In the case of the Western Cape, the Department of Environmental Affairs and Tourism added an 'inclusionary' planning prescription to its zoning requirements with respect to the development of golf estates. This prescription was, however, recently overturned by the courts which were of the view that it interfered with private land rights.

It is clearly the case that municipalities are already aware of their ability to use planning prescriptions to meet particular aims. For example, in the City of Cape Town, sale of publicly-owned land has included conditions that developments on the land must include a specified amount of affordable and low-cost housing. In another local government setting, the municipality of Emalahleni recently noted that the local councillors are directing the planning officials to set aside 60 percent of the municipalities' land for 'inclusionary' housing purposes (Interview, Parker, 2007).

[36] The 2003, Financial Sector Charter has set the price baseline for 'affordable housing'. Affordable housing is priced above the cost of the RDP subsidized housing, currently R38 000 and then adds 40%, bringing it up to between R50 000 and R350 000. The baseline income for someone renting 'affordable housing' begins at approximately R1 500 per month and stops at approximately R7 500 per month, plus 20%, resulting in a rental range of between R600 and R3 000 per month (FinMark, 2007, unpublished paper on Inclusionary Housing Bill Initial RIA).

Such dramatic and inflexible approaches could have negative economic consequences for the cities and towns they are implemented in.

Interestingly, the City of Cape Town is of the view that local authorities should always have precedence in making judgements about national prescriptions, especially when it comes to determining land usage. This is because they are far better suited to understanding local conditions and will generally act in their own best interest (Interview, City of Cape Town, 2008).

In summary, it would appear that government is striving for a flexible approach, more in line with influencing developers to carry out such delivery, rather than compelling them outright to enter the low-income market. Where the policy appears to compel developers to take certain actions, a range of incentives is provided that is intended to offset any losses they might experience. Only by implementing such a policy will one be able to determine whether any of the incentives are real, rather than in name only.

At this point in time it would appear that the national Department of Housing may be cooling on the idea of an ‘inclusionary’ housing policy. Until it decides whether to move forward on the idea and then drafts a Bill for public comment, as the devil will be in the detail, will it be possible to determine the degree of intervention government intends applying to the market. Clearly, the more government pursues an approach that compels certain actions on the part of the private sector, the higher the risk of the private sector exiting certain markets or of market players overriding the rules to reflect the realities of effective demand and supply.

3.6.2. A PROPOSED HOUSING DEVELOPMENT AGENCY

By now it is entirely clear that even though over 2 million houses have been built since 1994, government is very much aware of the fact that much of the land used to date has not been well located, but rather on the periphery of cities and towns and therefore has not contributed to the creation of sustainable human settlements. Moreover, as backlogs continue to increase over time, the fact that land is a finite resource and is therefore becoming scarcer and much more costly is persuading government of the need to take a more interventionist approach to the land market.

It is for these reasons that in 2006 the DoH began looking into the establishment of a Special Purpose Vehicle for Land as a means of intervening in the land market. The focus of the department’s exercise was to define a problem statement with respect to land delivery for sustainable human settlements, propose policy options and then come up with a regulatory framework for dealing with the issue (Interview, Thatcher, 2006).

PROBLEM STATEMENT

The problem statement formulated at the time noted that land acquisition strategies should highlight the advantages and disadvantages of supply-driven and demand-driven approaches. For example, the supply-driven approach means the state would be purchasing land and then making it available for housing development. The disadvantage of this approach is that the state has neither the resources, nor the capacity, to hold and manage land prior to it being transferred to local authorities. On the other hand, a demand-driven approach means that planning processes, e.g. the IDP process, drives land acquisition, therefore land is acquired when projects are proposed and approved, removing the need for a holding and managing function on the part of government.

A mid-year Cabinet Lekgotla in July 2006 resolved that the Minister of Agriculture and Land Affairs, in consultation with the Ministers of Provincial and Local Government and of Housing, should submit a memorandum on the details of a proposed SPV for acquiring land for housing delivery[37]. Since that time, the three departments have been intensely engaged in discussion on the matter[38].

PROPOSED HOUSING DEVELOPMENT AGENCY

The draft Bill notes that the previously described Housing Sector Plans are to be used to identify housing and land needs within their area. Moreover, the provincial housing departments will be responsible for coordinating these plans. The proposed Agency will then be expected to identify and acquire land on behalf of the provincial housing departments and municipalities. Noteworthy is the fact that the draft Bill provides for the Agency to expropriate land to fulfil Constitutional mandates around land and housing (Republic of South Africa, HDA Bill, 2008).

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[37] Subsequently a change of heart occurred in the Cabinet and in August 2006 a new Cabinet decision noted that the Minister of Housing, in consultation with the Ministers of Provincial and Local Government and of Agriculture and Land Affairs, was to submit a memorandum on the proposed SPV.

[38] A submission to MINMEC on the proposed policy was approved in September 2006. As a conflict had been simmering between the DoH and DLA as to whose responsibility it would be to carry out the mandate for acquiring land, in September 2007 Cabinet gave an in-principle directive handing the role for land acquisition for the development of sustainable human settlements to the DoH. A Business Plan to establish a Housing Development Agency has been submitted to the National Treasury, and has also received in-principle approval.

Until the Bill is passed, Servcon and Thubelisha Home Loans have been mandated to operate as an interim institution to carry out land acquisition, as well as provide support to municipalities with stalled housing projects[39].

While the original intent of the SPV was to acquire land, over time the proposal has been extended to cover the facilitation of project management on behalf of local authorities, promote fast-tracking of the housing development process and so on. These additional tasks would seem to be in response to the slow-down in housing delivery over the past few years, described in earlier sections. Hence, the establishment of such an Agency is being viewed, in addition to being able to acquire land, as a means of providing capacity to under-performing local authorities, particularly the low-capacity authorities outside the metros and secondary cities that are unable to manage procurement, project management and the other tasks necessary to carry out housing development.

If and when the Bill is passed, the new Agency, which most likely will be created out of a merging of Servcon[40] and Thubelisha[41,] will receive its initial capital from the existing MTEF allocation for Servcon, which was R60 million in the 2006/07 financial year. Additional funding will come directly from National Treasury through the Division of Revenue Act (DORA), most likely in the 2009/10 budget, i.e. through the Housing and Human Settlement Grant. The HDA will also be able to use its capital base to raise funds on the capital markets.

SUMMARY

The proposed HDA is a manifestation of government's frustration about the scale and pace of land and housing delivery, which is being held up due to a scarcity and therefore lack of affordable land. Government has determined that it will have to take steps to intervene in the land market and assist municipalities with carrying out housing delivery. Once the Bill is passed, the Agency will take a period of time to be established and staffed, so it will not have an impact on the land market in the short-term. In addition, in the draft Bill the Agency has the power to expropriate land, which is a far more interventionist approach in the land market than government has pursued to date. Whether it would use such powers remains to be seen. There is also the danger that the HDA is addressing the *symptoms* of local government failure, rather than addressing the *causes* at local government level.

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[39] There are precedents for setting up government agencies to deal with specific mandates, e.g. The South African National Roads Agency (Interview, Thatcher, 2006).

[40] Servcon currently carries out functions around land acquisition, land management and the provision of bulk infrastructure.

[41] Thubelisha currently carries out property management and development functions.

3.7. CONCLUSION

Starting with the Constitution, government is driven by a number of obligations, which include housing its citizens and providing them access to well-located land. Initially it attempted to fulfil these mandates through subsidies aimed at delivering housing to low-income people. Over time, however, it became apparent to government that while it may be able to, e.g. house the poor through the provision of subsidies, the location of the houses being delivered was not going to meet its aims of integrating urban areas. One reason for this was because subsidies were initially given to the private sector to deliver housing to the poor. They did so, however, on land they already owned, mainly on the urban periphery rather than where the poor would have access to urban amenities and economic opportunities. Moreover, apartheid planning instruments, still in place today, have had little impact on changing spatial patterns.

Of significance is the fact that there is a ‘golden thread’ running through government’s thinking, which is reflected in the policies included in the themes government has chosen to pursue in addressing its various mandates. These themes include e.g. spatial integration of cities and towns; reduction of economic inequalities; shifting patterns of ownership and creation of assets; planning in a participative manner; creation of ‘sustainable human settlements’; increasing densities and promoting inclusion; and are consistently reflected in its evolving policy positions. In pursuing these themes, government may increasingly find itself faced with the question of whether it can deliver on the many competing imperatives (e.g. economic, political, social and environmental, historical) it has set for itself or whether it will be forced to prioritise amongst them in the end.

When it comes to integrated planning exercises, it is still too early to gauge the success of IDPs as many municipalities have only just begun carrying out such processes and the early plans produced to date are not necessarily of the quality desired. Moreover, so far these plans have acted merely as guidelines rather than actual prescriptions. Nevertheless, through such planning processes municipalities are being required to face the tensions that arise between government imperatives to address the needs of the poor and their own more traditional economically-driven need to use their land efficiently.

Government is keen to increase the impact of IDPs and is focusing on the issue of intergovernmental relations as the means to do so. It is also looking to extend the impact of IDPs, and the requirement that municipalities now produce Housing Sector Plans (and potentially ‘inclusionary’ housing plans) will be used to accomplish this.

Government is also seeing a need to become more interventionist in its approaches to the private sector, particularly when it comes to delivering sustainable human settlements. The recently proposed ‘inclusionary’ housing policy, if adopted, would provide government with its most interventionist tool to date. The private sector is concerned that if government indeed becomes more interventionist in its approach, it should not end up having a negative impact on the property market in general. Government must be sure that, whatever approach it pursues, it does not result in the private sector being driven out of the market. Evidence seems to suggest that incentives are a far more effective tool for achieving policy goals than prescription, although this is contrary to the direction in which government is moving.

Whether or not national government decides to pursue more interventionist policies remains to be seen. Nevertheless, municipal government is beginning to wake up to the idea of using planning *prescriptions* as a means of guiding land usage in their area in a way that will meet development aims. This situation will need to be monitored over time, as it does have the potential to impact on the urban land market, depending on how intensely and where it is applied.

Government has also determined that it must become an active player in the land market. This is because it views municipalities as unable, on their own, to source sufficient land for low-cost housing. More specifically, driven by a market imperative which generally sees land being sold to the highest bidder, municipalities are unable to source the land they need without having to compete for it at market-related prices. Government’s recently proposed Housing Development Agency seeks to fulfil this role for municipalities and, if passed, would be able to employ expropriation as a means of fulfilling its aim. As the prior discussion highlights, this would have consequences for the operation of the market, which more market-incentivising interventions, e.g. based on market-driven densification incentives, would not.

Where government is really feeling a sense of frustration, however, is when it comes to its ability to carry through on its various mandates and implement its policies. As policies and programmes become more complex, the skills and capacity of the public sector are being tested and stretched beyond manageable levels, thereby diminishing their ability to implement policies and programmes effectively. Moreover, important functions which are core to the effective operation of property markets, in particular the zoning of land, the establishment of townships, the titling of land and related transactions support functions, are slowing down as the public sector, particularly at a local level, becomes more stretched and less efficient over time. Hence the widespread market perception, as quoted in Business Day, that government continues to develop Rolls Royce policies while having to rely on the

Uno engines of municipal government to drive them forward (*Business Day,* 28 August 2007).

In short, this section has raised a number of issues, including:

- contradictory and competing roles and responsibilities across spheres and tiers of governments (DLA, DoH, DPLG);
- confusing policy and legislative prescriptions (DFA, Ordinances, LEFTA, MFA, PFMA, EIAs);
- inability to set priorities (e.g. protect the environment versus house the poor) and the conflicts that then arise between them;
- extremely slow policy and legislative processes (Land Use Management Bill, Social Housing Bill, Inclusionary Housing Policy/Bill); and
- poorly capacitated local authorities already unable to keep up with and manage normal development processes.

These issues point to the fact that, while the state has not implemented market-unfriendly policies, the policies in existence have not been properly implemented. The problem therefore lies not so much with the actual policies, but with their execution. Later sections discuss how uncertainty around these processes and lack of execution impact on the market. Most significantly, if it does not address these issues government will find that both its delivery targets and the ability of the private sector, through a well-functioning urban land market, to help in the delivery process will be undermined.

4. KEY THEMES

The previous sections have provided a picture of the formal urban land market in South Africa in respect of its spatial dynamics, the players in the market, trends in respect of prices and affordability, as well as the policy and regulatory environment within which the market operates. This section aims to draw out the key themes that emerge from our review, and the drivers that underpin this market to explain the key features that characterise its structure and operation.

4.1. THE URBAN LAND MARKET IS DOMINATED BY A FINANCIAL LOGIC

The first point to make is that our research indicates that the urban property market is not an inherently broken market. At the macro level, this market functions well, and responds predictably to the forces of demand and supply which allocate land to the best and highest use as determined by price. In pure economic terms, this indicates a degree of efficiency. As demand for a particular piece of land increases, so the price for that land increases. This is largely due to the spatially differentiated, non-homogenous nature of land. Unlike most other commodity markets, the value of land is closely tied to its location, which cannot be changed. Each piece of land is therefore a slightly differentiated product with unique characteristics, and is therefore subject to a unique demand. Market forces of demand and supply will allocate each piece of land to its best and highest value use, as dictated by its locational and related features. This allocation will typically be determined by price, which simultaneously acts as the driving force and the clearing mechanism of the property market. The immediate implication of this is that affordability is the key determinant, and access to finance a necessary pre-condition, for any actor to participate in the property market. In this respect, the property market is no different to any other commodity or service market.

As illustrated in Diagram 8 (Section 1), different sectors bid for land based on its use value to that sector. If the residential ‘sector’ places a higher premium on the location of any particular parcel of land (i,e. is willing to pay a higher price) than another sector, then that land will go to the residential sector. This is why well located and serviced land is expensive and can only be bought by those with a high income. In this sense, the formal urban land market favours the wealthy who are able to purchase prime land, and discriminates against the poor who are unable to afford this well located land as they are outbid by other players in the market who are able to pay a higher price.

The market drives the dynamic of change, investment and growth within and between different property sectors. Over time, preferences and the premium that different sectors might place on the location of land may change, manifesting in price changes and the possible conversion of land between different uses and sectors as they begin to outbid each other and respond to new circumstances and opportunities. This manifests in the development of new nodes such as Sandton, which, for example, resulted in land in the north of Johannesburg suddenly becoming well located and valuable, as residential bidders began to outbid agricultural users of the land. Land which has already been developed in terms of one particular use can also be affected, with conversions from office to residential buildings beginning to occur across the CBDs of all South Africa's major cities. This process of conversion often results in relatively affordable, well located accommodation.

The conversion process can be either hindered or accelerated by a variety of macro, institutional and policy factors. In the case of the progressive conversion of SA's inner cities from exclusively commercial into residential nodes, this has been significantly driven by the UDZ incentives (as discussed in section 3.4.4). Such dynamics may of course give rise to their own set of problems, as local authorities then have to begin adjusting the nature of their role and function as, for example, the need for increased social services in formerly commercial areas emerges.

Because they are manifestations of the preferences of different market players, these market forces are typically strong enough to prevail in the face of possible 'distortions' that might arise from policy interventions. If land is 'mis-allocated' through non-market related interventions, market forces will act to re-allocate this land to what prevailing market perceptions deem to be its best and highest use. This is a problem faced by local authorities who may follow the political imperative to locate low-income households on well located, high-value land, close to places of work and services. Residents of these developments quickly realise the additional, implicit subsidy they have been given and may consequently sell, let or sub-let the property, often in the informal market to occupants drawn from higher-income groups. In terms of the logic of the market as it currently operates, this can be seen as a rational and predictable response.

In the Cape Town metro, housing officials cited several examples where residents have moved out of their subsidy-financed, formal houses and returned to backyard shacks or informal settlements so that they could let their houses to wealthier people. Whilst this may provide an additional income stream to the household, it does not address their poor state and location of housing, which was the overriding intention of the original housing intervention. It also comes at significant cost to the public fiscus and does not represent a sustainable or cost-effective solution to the challenge of providing affordable housing solutions to poor households, at scale. Moreover, these rentals typically take place in the informal land market, which is unregulated, leaving both tenants and landlords at potential risk. Informality also undermines the ability of poor households to use their houses as capital assets, i.e. as collateral for loans, or simply to benefit fully from capital appreciation trends that might affect the neighbourhood.

Interventions of this nature thus represent an inefficient use of government resources as the state or local authority, as a player in the market, is bound to pay a market price when acquiring this land, before converting it to what in the eyes of the market is a 'sub-optimal' land use. Even if the land is owned by the state in the first place, it is strictly more efficient to sell the well located land on the open market - thereby maximising its revenues and expanding its future rates base. Both are vital additional sources of funding for future housing developments and support a variety of transport, social and enterprise development initiatives which may be established in support of poor households who have been housed elsewhere.

These kinds of interventions confer a windfall subsidy to the participants in such a housing development. This means that in addition to the subsidised house they may receive, they receive an additional implicit subsidy in the form of valuable land. In time, they are likely to respond to this reality by sub-letting or selling, thereby a) converting this subsidy into a once-off windfall gain, and b) undermining the original objective of housing provision for the poor. Housing authorities frequently respond to this prospect by invoking legal provisions which prevent the targeted inhabitants from selling their house – either for a period or forever. This represents an additional market distortion and may bring with it significant additional enforcement responsibilities and costs. This also forces those wishing to use their house as an economic asset, either by selling or renting, to participate in the informal market.

The conclusion we therefore draw from our analysis of the market is that, while it will not always (least of all in the South African context, given the apartheid legacy of neglect and distortion) of itself deliver the desired social/housing outcome, state interventions towards this end need to take account of its logic and should seek to work *with* the market, rather than *against* it. The experience of existing UDZ incentives being used to catalyse private sector investment, upgrading and transformation in SA's inner cities for the benefit of historically excluded households is an example of the role the market can play in contributing to the fulfilment of the state's pro-poor housing objectives.

4.2. THE HOUSING LADDER EXTENDS FURTHER THAN PREVIOUSLY THOUGHT

The logic of the urban land market in South Africa dictates that affordability is the fundamental prerequisite for participation in it. Our analysis in Section 2 indicates that, in both the commercial and residential sectors, the differential growth in prices across suburbs over the last ten years has begun to enhance access by poorer households and those formerly excluded from the formal property market. In effect, the property market ladder has been extended to households and communities who were historically beyond its reach. Moreover, the availability of commercial housing options on the bottom rungs of this ladder has grown.

In the commercial sector, a wide variety of rental and ownership opportunities exist across all the main metropolitan centres for renters and investors alike. This is reflected in the variation in available rental rates from around R55/m² at the lower end, to well in excess of R100/m² at the upper end of the commercial market.

In the residential sector, detailed deeds registry data collated as part of the research indicate that many formal residential suburbs, and particularly those at the lower end of the market, have become more affordable over the past ten years. An assessment of the extent of the housing stock to which this reality applies (the ‘thickness” of the rungs) was not possible, but our data indicate that median house prices across a number of residential suburbs in all metropolitan cities have fallen in real terms. In the context of the strong economic growth experienced by South Africa over the same period, this would suggest that the affordability of houses at the lower end of the formal market is being enhanced– although this does not necessarily impact on access by households which exist at the bottom end or outside the formal economy. Our calculation of the incomes needed to access houses at the affordable end of the commercial ladder indicates that these are well within the upper limit (and in some cases as low as R5 500 pm) of the Financial Sector Charter affordable housing bands (which in 2007 had an upper limit of R8 800).

A related finding suggests that households are increasingly able to move between former township areas and the suburbs. The price range of houses in ‘township’ and suburban areas overlap, which suggests that homeowners are able to move between different suburbs in a way that was previously not possible because of the existence of suburban price ‘cliffs’ confronting residents of former township areas. The extent of the overlap in price bands between such areas also indicates that the housing ladder is relatively smooth, and that the price increments between the various rungs at the lower end are relatively small.

Clearly, these findings are of little immediate consolation to those households whose incomes fall short of enabling access to the first rung of the housing ladder. This is something that the market acting alone cannot address. This accessibility gap is a function of many things, not least of which is the economy's ability to grow employment and raise the incomes of greater numbers of poorer households to levels necessary to enter the housing market. In the light of current increases in interest rates, together with spiralling fuel and food prices, the challenge of affordability is likely to be central to the housing issue in South Africa. However, there is a range of possible interventions that government might explore with a view to extending the housing access frontier and to ensuring that the commercial ladder is more accessible to poor households. Some of these possibilities are briefly explored later, but critical to their success will be that they are designed and implemented in such a way as to enhance, rather than to detract from, the effective operation of the market.

4.3. SCARCITY OF LAND IS DRIVING COST

Just as municipalities have a defined area, cities have a defined 'urban edge[42]' within which land is zoned and serviced. This makes the amount of land available for development a finite resource, as it is unusual for the urban edge to be extended. In fact, there are usually restrictions in place preventing land beyond this boundary from being sub-divided. This is driven by a planning philosophy which aims to prevent urban sprawl and promote densification.

The consequence of this is that land becomes a scarce and frequently speculative commodity. This is a country-wide phenomenon, as reported by Business Day on 23 January 2008 when it stated that "for the first time there is a shortage of land in South Africa" – referring in this case to urban land. This helps to explain why land prices in all SA cities, and particular those such as Cape Town which are additionally constrained by the mountain and sea, are so high. Land for housing is a particularly scarce commodity, and reports of a lack of zoned land are already emerging. Developers cannot find suitable land to develop, and Cape Town city's housing department is being forced to pay over R1.5 million per hectare for land on the periphery of the city for low-cost housing. If supply is finite, an increasing demand simply raises its price.

The diagram below illustrates how increasing demand in the face of constant supply will raise prices. At a certain point, the supply of land becomes vertical, which means

[42] The urban edge is comprised of two key components, a cadastrally defined urban edge line, and management zones on either side of that line. It is essentially a strategy to counter low density urban sprawl and protect the natural resources and unique character of different areas within a city, and assist with directing the form and pattern of city growth. (Source: City of Cape Town)

that no new land is being zoned in response to demand. Unless the city can expand its urban boundaries and zone more land (i.e. increase the supply), then continuing increases in demand (D_1 – D_2 – D_3) will simply push prices higher and higher – from P_1 to P_3. These increases in price are not accompanied by any increases in the supply of land, so while prices rise, the amount of land available remains the same. What this phenomenon does induce, to be discussed further below, is the clear incentive amongst all players in the market to densify.

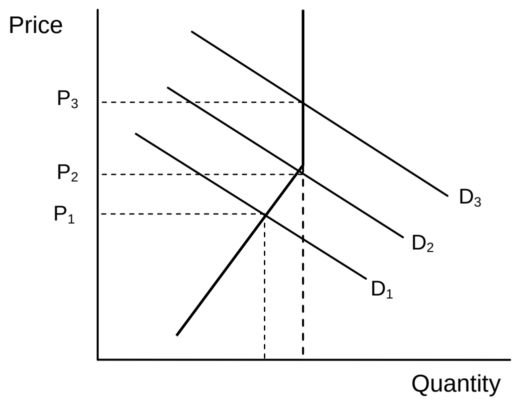

Figure 14: Increasing demand & constant supply

Source: Genesis Analytics

There is also a lack of well located land in cities. Where well located land is owned by public authorities, this land is valuable and a choice has to made between allocating the land to housing developments targeted at the lower end of the market, or to sell the land to a developer of private housing for more money. The latter option also results in a higher rates base for the city. The Public Finance Management Act requires municipalities to attract competitive bids for land. This has been cited as a barrier to council-driven developments on well located land. However, innovative ways around this requirement are being found. For example, land availability agreements between municipalities and large developers are being signed, whereby the developer develops the land in question, and once occupation has taken place, the title is transferred from the local authority to the resident. Within the local authorities interviewed, there was a strong commitment to developing housing on well located council-owned land wherever possible. This is tempered by a pragmatic approach in cities such as Cape Town, where particularly prime land is removed from such projects and is instead sold. Ideally the proceeds from such a sale would be used for similar projects, although this is not always the case.

Whilst the scarcity of zoned land is largely driven by the planning construct of an urban edge, with the aim of limiting urban sprawl and densifying cities, there is a noticeable lack of appropriate densification policies throughout South Africa. In fact, some developers interviewed reported that planning authorities regularly order the scale and density of planned developments to be reduced. These authorities are usually council officials, although in Cape Town the heritage authorities appear to be particularly influential in imposing building restrictions that reduce overall bulk (the number of square metres allowed on a piece of land). Thus, at the city level there appear to be conflicting policies – one that wants to prevent urban sprawl and promote densification, and one that aims to keep densities down. Moreover, beyond the scope of the existing UDZs (which are themselves highly restricted in terms of their spatial areas and qualifying beneficiaries), there are few policies, instruments and incentives which aim to facilitate market-driven responses to the densification imperative. In the face of limited and contradictory polices, it is not surprising that land values continue to grow strongly in real terms, given the enormous unmet demand that currently exists across all market sectors.

4.4. POLICY AND REGULATION IS FREQUENTLY ONEROUS AND FOCUSED ON TOO MANY, OFTEN CONFLICTING OUTCOMES.

Section 3 outlined the policies and regulations impacting on the urban property market, and it is worth considering the overall impact of this plethora of legislation on the operation of the market.

The roles, functions and mandates of government departments conflict and overlap, both horizontally (between national departments) and vertically (between national, provincial and local). This can create confusion and uncertainty within the market as various spheres of government intervene in different ways. For example, the Department of Environmental Affairs enforces environmental prescriptions, the Department of Arts and Culture is responsible for heritage considerations and the Department of Provincial and Local Government is responsible for local authorities. This range of mandates can have conflicting objectives and it is important to note this.

Most importantly, government policy is frequently focused on market *outcomes* such as integration, inclusion and equity, rather than ensuring the efficient functioning of the market in pursuit of shared ends. Where these desired market outcomes are not compatible with existing market dynamics, they can be difficult to achieve. A case in point concerns the government's goals of integration and inclusion, both of which have only been achieved in as much as the economic empowerment of previously disadvantaged South Africans has been met. As some within these groups have acquired wealth, and as the distortions of apartheid have been removed, they have migrated to better areas and have inspired the effective conversion of land use between different sectors. The pace of racial integration in SA's formerly 'white' suburbs is essentially a function of the pace of broad-based empowerment of previously disadvantaged groups, employment creation and growth.

The themes of integration and inclusion, coupled with the constitutional mandates around housing, have created a role for the State in which interventions are necessary, as the market clearly cannot achieve these envisaged outcomes unassisted. While the spatial focus and consequences of apartheid planning demand corrective intervention at scale, government frustration with the pace of spatial transformation appears to have resulted in a more prescriptive approach over time, with the upcoming amendments to the Expropriation Act and the proposed Inclusionary Housing Policy the most prominent examples of this. Government policy is becoming increasingly focused on achieving these desired outcomes.

Whilst housing policy is focused on achieving these outcomes in the residential market, at the same time there is a variety of other legislation which governs other aspects of the property market, the most influential being environmental and heritage legislation. While these laws and policies are in many cases well justified, there is some evidence that they are conceived and often applied in isolation of one another and often mitigate against achieving other policy outcomes. For example, a more dense, less sprawling city is an often stated planning goal enforced by an urban edge policy, yet densification is difficult to achieve as environmental and heritage approval processes can result in a restriction of the number of square metres allowable on any particular housing development site.

The 'land-to-stand' planning and approval process is an onerous and expensive one in South Africa. Whilst these approval processes are often necessary and important, the point to note here is that re-zoning applications, environmental reports, heritage approval and the like add significantly to the time-scale and ultimately to the transactions costs of any particular development. This reduces margins and causes developers in many cases to exit the market – particularly at the lower end. Moreover, these costs are ultimately passed on to the consumer, adding to the price of residential, commercial and industrial land.

There are some cases in which legislation directly inhibits the functioning of the market. A good example is the Prevention of Illegal Eviction (PIE) and the Rental Housing Act, which govern landlord tenant relations. The former makes it difficult for landlords to evict non-paying tenants, whilst the latter allows for recourse in the case of “punitive rents”. The acts have laudable goals, and are aimed at curbing the power of unscrupulous landlords. However, they have simply resulted in stringent screening measures being put in place by landlords to ensure that the tenants in their buildings will be able to pay. Potential tenants without a formal, consistent income stream are excluded from consideration as they are more likely to default on their rent, after which it becomes an expensive and arduous process to evict them. Should these regulations be tightened even further, there is the possibility that landlords may simply opt to invest in higher income areas or perhaps in industrial properties where similar restrictions do not apply.

4.5. STATE INTERVENTIONS IN THE MARKET

4.5.1. HOUSING

Low income housing is the sector of the market in which the state focuses most of its resources, largely through the housing subsidy. As has been explored elsewhere in this report, this is driven by both constitutional and political imperatives. This housing is aimed at those earning below R3500 a month, i.e. those for whom the market cannot deliver housing. It is beyond the scope of this study to engage in a detailed analysis of the effect on the market of the housing subsidy. Indeed, there is currently other work being completed which focuses specifically on this topic. It is however relevant to note that the housing subsidy is having an impact on the market, partly because the state has become an active player within the property market, albeit driven by motives other than return on investment.

4.5.2. INCENTIVES

There are few incentives offered by the State, but of those that exist, the most successful has been the Urban Development Zones (UDZ’s). This is a good example of a market-enabling intervention. Policymakers realised that the decay of inner city areas in South Africa needed to be addressed. Rather than embark on a programme of state intervention, the policy goal of upgrading and revitalising the inner city has been achieved (to some extent) by the use of a tax incentive. There is some argument that this upgrading would have occurred even in the absence of the incentive, but it is difficult to argue that the upgrading would have taken place at the pace and to the extent that it has done.

Unlike explicit state intervention, a tax incentive acts as a catalyst incentivising action rather than prescribing it. It explicitly leverages the logic of the market to realise an outcome which might not have been pursued or as effectively achieved without it. Fundamentally, market-compatible incentives crowd-in rather than displace market players, and they strengthen rather than distort the operation of the market. As a result they are typically associated with low enforcement costs. In the case of the UDZ, this incentive has had an impressive impact in a relatively short space of time. The eThekweni metro reports investment exceeding R1 billion in its UDZ, and the success of the UDZ in Johannesburg's inner city is well documented – most of it targeted at the urban upgrading and the creation of residential accommodation at the lower end. The UDZ represents a powerful example of the impact that judicious, enabling interventions by the state can have on the market and its ability to deliver on social outcomes.

4.6. CAPACITY PROBLEMS AT A LOCAL GOVERNMENT LEVEL SLOWS SUPPLY AND DISPLACES MARKET PLAYERS

The somewhat onerous process of gaining the necessary approvals for moving from 'land' to 'stand' has already been alluded to. More than the process itself, the speed and predictability with which it occurs is important. During interviews conducted for this study, it became apparent that a lack of capacity at local government level is causing excessive delays in this process. This is combined with a growing sense that local authorities are failing to effectively fulfil their core mandates of facilitating planning services and approvals, rates collection and bye-law enforcement. Compounding this is the perceived 'mandate creep' of these authorities, whereby new roles and functions are added to core tasks, resulting in an overstretched and under-equipped staff chasing a multiplicity of objectives. This acts to slow down the operation of the market, undermines the confidence and raises the risks and costs faced by private sector players. Manifesting initially as "grit in the cogs", these difficulties and the dilution of local authorities' core business undermine the effective operation of a market, and can cause the displacement and departure of highly effective investors and developers.

Developers and market facilitators interviewed in the course of the study[43] highlighted deteriorating levels of service and delays with respect to core functions of Johannesburg city's planning and transactions support functions. Principally, this refers to extensive delays in obtaining rates clearance certificates (a pre-requisite for the sale of buildings and apartments) and planning approvals for a variety of conversions, upgrades and infrastructure (power, water etc.) connections. Such delays translate directly into costs, and uncertainty regarding the duration and outcome of these processes increase risk. Together, these undermine investors' margins and raise costs for the end-user. Their cumulative effect is to encourage the departure of investors and operators to other market sectors.

[43] Jozi Housing; Trust for Urban Housing Finance

At a more systemic level, the alleged widespread failure of the local authority to collect rates and to enforce local bye-laws undermines the investment and operating climate for legitimate players. Affected buildings fall into disrepair and neglected streets and neighbourhoods rapidly encroach onto well managed areas, causing a contagion of poor enforcement, grime and crime. To protect themselves, investors have increasingly undertaken local cleaning, maintenance and enforcement services, thereby adding to their costs and risk, and progressively eroding the ability of the market to function effectively.

The operation of the urban property market and the effectiveness of private players within them would be greatly enhanced if local authorities were to fulfil the requirements of their core functions more effectively.

4.6.1. GREENFIELDS DEVELOPMENT

Greenfield development refers to development of previously vacant land. In most cases, the land is unserviced and needs to be re-zoned (usually from agricultural to whatever the proposed new use is). In Gauteng, developers report that the process of re-zoning land, gaining the necessary approvals and getting the local authority to provide services etc., can take up to five years before construction takes place. Officials in Durban maintain that communication with an applicant takes place within 6 months of an application, whereas in Cape Town there is recognition that the process can be improved. Whilst it is beyond the scope of this report to detail the problems underlying this, it is worth discussing the implications of these types of delays on the market.

A developer who has bought undeveloped land has incurred a cost. Holding this land incurs “holding costs”, the bulk of which are usually interest repayments to the financial institution from which the initial capital was borrowed. Every month that the land lies unused and undeveloped is another month that the developer must incur costs on the piece of land, not to mention the ‘opportunity cost’ of foregoing the development of other possible sites. Upfront costs of electricity connection must also be paid, as must the costs of environmental impact assessments. These costs are not offset against any income stream from the piece of land, and so developers must be able to fund them. These costs are not insubstantial, and there are few developers with the scale and capital funding to be able to meet these costs over several years. For example, Tongaat-Hulett Developments in Durban indicated that, were it not for the fact that their designated land was farmed for sugar prior to development (thus providing an income stream), they would likely have gone under or at the very least experienced severe cash flow problems and reduced investment returns.

These problems are particularly prevalent for developers of low income housing, where margins tend to be lower and where construction is taking place on previously undeveloped land. Indications from developers are that many smaller developers have exited this market completely, as they cannot meet the holding and related transactions costs involved. It simply makes better business sense to construct upper-end housing in already established suburbs, where risks are lower. Moreover, when delays and additional costs are incurred, these can be passed on to the consumer, whereas at the lower end of the market there is a greater sensitivity to price.

This has resulted in only very few developers – those with the resources and internal capacity to manage the costs and risks - operating in this segment of the market. This dearth of developers is partly responsible for the lack of supply of affordable new housing in South Africa, although it is important to note that this in itself is a topic for further research. One result of smaller developers being driven out of the market is that banks in South Africa are now moving into this space as developers of affordable housing.

It should be noted that this phenomenon is largely driven by the dilemma faced by SA's major banks, of charter requirements for lending on the one hand and a low or non-existent supply of affordable housing (for reasons outlined above) on the other. As smaller developers exited the market, banks have entered with a view to increasing the supply of affordable housing and hence increasing the number of mortgages they can offer to this end of the market. This is not necessarily a negative development, as large financial institutions in South Africa have the capital and systems to absorb and manage many of the holding costs which cripple smaller developers. Banks are also in the fortunate position of owning large amounts of land suitable for low cost housing development, and they pro-actively seek partnerships with local authorities to ensure that housing developments are able to occur. Nonetheless, it is interesting to note this outcome; lack of capacity and onerous procedures at local government level have contributed to making the development market less competitive, by driving out smaller players unable to incur holding and related costs. This is an example of the market responding in specific ways to specific environmental factors.

4.6.2. BROWNFIELDS DEVELOPMENT

Although the land-to-stand process is onerous, much development takes place on land that is already zoned and serviced. This eliminates many of the problems faced by greenfields developers. However, as discussed, there are still serious constraints.

Rates clearance certificates and service re-connections– routine, core local authority functions - are typically experienced as arduous and time-consuming processes. In the Johannesburg inner city, private developers who refurbish buildings suitable for low income rental, report delays of up to ten months in electricity connections being installed. This results in lost income and additional holding costs as flats cannot be let. At least one developer reported that the hassle factor in dealing with the city was such that other developers had moved into industrial and commercial development as an easier alternative to residential development.

Given the excellent location of much of the inner city in terms of proximity to economic activity, one might expect local government to prioritise this type of market-based, private sector-led re-development and upgrading process, as it increases the stock of housing close to the CBD and upgrades the surrounding area, at no cost to its own housing budget.

5. RECOMMENDATIONS

Outlined below are a limited number of recommendations which we believe are supported by this study, and which might usefully guide policy review and formulation in this sector. Given the macro-systemic nature of this review and its focus on the determinants of the operation of formal property markets in South Africa, it is difficult to define specific recommendations which in themselves or even together will overcome the barriers to access by poor households to urban housing and formal shelter. South Africa's legacy of exclusion and inequality, and the persistent high levels of unemployment will continue to be the fundamental determinants of access for the poor.

Appropriate government housing policies and related interventions, whether at a national or local level, are essential to accelerate the redress of historical backlogs and distortions, but their impact will necessarily be incremental, over time. The effectiveness and impact of these interventions will, we believe, be greater, the more market-compatible they are in their design and implementation, and the more they leverage off the market's inherent logic. As the recommendations below indicate, this relates as much to the state's overall policy and orientation *vis-a-vis* the market, as to the design of specific interventions, whether at the national or local level. The effectiveness of public sector policies in the property market will also be determined by their ability to alter the institutional framework in which markets function and hence the behavioural characteristics of market players. Altering the rules of the game opens opportunities for players that have previously been excluded from the market or who have found it difficult to access the market. Government as a player in the market has a role to play in this regard.

The section concludes with specific research recommendations which Urban LandMark and others may consider pursuing.

5.1. RECOGNISE THE POWER OF THE MARKET – AND ITS LIMITATIONS

At a generic level, the first recommendation that arises from our research would be for government and its agencies to appreciate the logic that underpins the formal property market and the implications this has for the way it operates. As far as possible, government should align its policies and interventions in the market to work *with* the market, rather than seeking to work in isolation of it. Policies and interventions that are contrary to the market's logic and its rules of the game, will tend to undermine existing institutions, compromise sustainable delivery and enhance reliance on the state for delivery. Policies that harness the power of the market and which reflect institutional and incentive arrangements that target previously marginalised groups stand to provide better outcomes than those relying exclusively on the state for delivery. Beyond intervening to change the shape of the market, the public sector can also intervene through instruments that enhance the knowledge, skills, relationships and market information of potential entrants in the market.

Fundamentally, the state has a vital role to play in harnessing the power of the market and broadening its access to new players. Our recommendation that it take more cognisance of the market therefore is *not* premised on the notion that the market should be left alone to correct the legacy of distortion, exclusion and deprivation in SA's property market. Rather, government should seek to enable, catalyse and incentivise market forces to achieve its desired policy outcomes whilst incorporating new players.

This should begin with a systematic review and assessment of its policies, regulations and interventions, to evaluate the extent of their market compatibility and their likely impact on its ability to deliver on government's property market goals.

5.2. PUBLIC INTERVENTIONS SHOULD BE MARKET-ENHANCING AND INCENTIVE-COMPATIBLE

There are several ways in which policy makers can harness the power of the market. This goes beyond simply ensuring that policies and interventions are not in conflict with the logic of the market. It involves understanding the causes of apparent 'market failure', and the design of policy instruments and amendments to "the rules of the game" aimed specifically at addressing these. In this respect, the following themes emerge:

5.2.1. INCENTIVES ARE MORE POWERFUL THAN PRESCRIPTIONS

Market-compatible incentives are likely to be more effective in shifting market behaviour than government prescriptions. At present government's policies offer few incentives relevant to the growth and transformation of the urban land market, and there are signs that the state is planning to adopt a more interventionist role in the market, as a direct player. This is likely to detract from, rather than to enhance the delivery of sustainable, cost-effective solutions to the problems of exclusion in the urban property market.

By way of example, consider the challenge of densification and the imperative of improving the efficiency of all SA cities. The imposition of an urban edge coupled with a shortage of zoned land has made policies in support of densification an urgent issue. Yet there are no incentives in existence or planned to facilitate this process. Instead, the government is developing a policy of ‘inclusionary housing’ which relies on a range of prescriptions aimed at property investors large and small, which are coupled with complex and discretionary allowances built into an already overburdened local planning function. In its place we would advocate an approach which incentivises property owners, large and small across the urban landscape, to take the initiative in densifying their properties – i.e. by building or converting a second dwelling for rental or sale – in exchange for a tax or rate rebate, contingent on the densification outcome. This would in our view go further towards achieving the goal of densification and, in time, integration of residential suburbs than onerous investment regulations which are likely to displace investors and distort incentives, and which at best are likely to make a marginal contribution to the government’s goal.

Currently, the best example of significant urban property market incentives in South Africa are Urban Development Zones. Incentives such as these have worked well, directly contributing to (if not in themselves catalysing) the re-generation of inner city areas across the country. The incentive principles underpinning UDZs should be expanded in scope, scale and application across all sectors of the urban property market so as to channel market forces towards the fulfilment of development outcomes. Another market-developmental incentive currently in existence is the exemption of transfer duty on the sale of houses valued less that R500 000. The 2008 budget speech made mention of an intention to explore and expand the current tax treatment for employers offering affordable housing to their staff. Such initiatives, and the principle which underlies them, should be accelerated and extended so as to align the logic and power of the market with the government’s delivery challenges in the formal property market.

5.2.2. THE NEED FOR LEGISLATIVE SIMPLICITY, COHERENCE AND CERTAINTY

One outcome of policy instruments which run contrary to the market’s logic is that investor confidence is reduced.Higher levels of uncertainty result in lower levels of development and developers redirect their activities accordingly. Developers and related players in the market need clarity and certainty, regardless of the policy. At present, the proposed amendments to the Expropriation Bill, the proposed inclusionary housing policy and the envisaged Housing Development Agency create a degree of uncertainty in the market which is not conducive to investment and long-term planning. As uncertainty increases, so risks and costs for developers and other players increase.

At a legislative level, the simplicity and coherence promised by the much-delayed enactment of the Land Use Management Bill would mark a major improvement in the contradictory and overlapping legislative environment that currently characterises the urban development market. Every effort should be made to ensure the enactment and implementation of this Bill in 2008.

5.2.3. ENHANCE AFFORDABILITY, ACCESS AND SUPPLY AT THE BOTTOM OF THE COMMERCIAL RESIDENTIAL PROPERTY MARKET

The research presents evidence of the enhanced affordability of many low-end suburbs in the formal residential property market across all major South African cities. This suggests that the formal property market 'ladder' extends further into lower-income groups than was previously the case, and now extends to well within the target income bounds prescribed by the Financial Sector Charter. However, in order to broaden and deepen the base of the housing ladder in South Africa, there is an urgent need for policies and incentives which improve affordability and expand supply at this, the entry level, of the housing market. Specific measures which could be considered are the introduction of mortgage tax relief for homeowners at the lower end of the price and access ladder, introducing finite and declining interest rate subsidies for low-end first-time buyers, and enhancing the incentives that already exist in respect of employer-financed housing and accommodation schemes. Specifically, the depreciation allowances currently available to employer-developers for the construction of low-cost housing and associated public infrastructure should be enhanced. Equally, in the case of employer-provided low-cost housing, further relief with respect to fringe-benefit taxation in the hands of employees should be introduced. Greater attention should also be given to exploring how the government's housing subsidy scheme might be used as a demand-side instrument to facilitate entry by poor households, who would in normal circumstances not be able to access the first rung in this ladder. Specific research ideas for Urban LandMark to consider in promoting this agenda are presented further below.

5.3. LOCAL AUTHORITIES SHOULD PRIORITISE THE FULFILMENT OF THEIR CORE FUNCTIONS

Ultimately it is local authorities who are at the coalface of the property market. They are responsible for implementing the plethora of policies and legislation enacted at the national level. They are also responsible for other municipal functions such as the provision of planning, transactions support and enforcement services. Evidence from this study indicates that many local authorities face capacity problems which are exacerbated by the additional responsibilities being placed on them by new legislative interventions. This makes it increasingly difficult for them to fulfil their core planning and regulatory functions. This is compromising the effective operation of property markets and in some cases is causing the departure of market players.

It is vital that local authorities focus on creating an environment conducive to private investment, development and letting activity whilst also making it possible for new entrants to enter the market. This involves ensuring that planning approvals are processed timeously, that bye-laws are enforced and bulk services installed within a reasonable period, and that there is regulatory certainty. Public sector authorities also have a role to play in ensuring that appropriate social infrastructure (schools, clinics, recreational facilities etc.) is made available when upward filtering or extensive conversion of office to residential accommodation does occur in suburbs. Without this, social pressures emerge, placing strain on all available facilities and services, which in turn can result in the displacement of market players. Addressing these problems will lower the transactions costs and risks of operating in the urban property market, and will result in increased market activity at all levels. This will directly expand the supply of properties in all sectors of the market, which will tend to ease the upward pressure on prices.

Finally, local authorities also have responsibility for the planning of the urban area under their control, including the urban edge. Whilst the merits of this planning tool are not debated here, local authorities should ensure that interventions such as these are balanced with appropriate policies and incentives to enable densification.

5.4. POSSIBLE AREAS OF FUTURE WORK FOR URBAN LANDMARK

The recommendations discussed above are at a broad level, and draw on the evidence and overview presented in this report. We conclude with a limited number of suggestions regarding possible research and development work which Urban LandMark and others might pursue.

VERIFY THE EXISTENCE OF A RESIDENTIAL AND COMMERCIAL PROPERTY LADDER AND THE OPERATION OF THE MARKET FILTERING PROCESS

The broad scope of this study did not allow for sufficient in-depth research to explore the extent or downward reach of the urban property market ladder or the related operation of an upward market-filtering process. Targeted additional research should be pursued with a view to exploring their practical existence, operating features and implications for property market policy.

EXPLORE THE FEASIBILITY OF PUBLIC-PRIVATE PARTNERSHIPS AND INCENTIVES TO EXPAND ACCESS AND AFFORDABILITY AT THE BOTTOM END OF THE RESIDENTIAL PROPERTY MARKET

We would advocate the investigation of specific market-based instruments to broaden and deepen access to the residential property market. This could include the investigation of mortgage tax relief arrangements, which target specifically the bottom end of the market, as well as the use of market instruments which blend private capital with government support to reduce the volatility of interest rates for households entering the property market for the first time, at the bottom rung. A related area of research might be the feasibility and likely impact of implementing a finite and declining interest rate subsidy for first-time market entrants. Comparative research might also be undertaken into the experience and operation globally of mortgage-sharing and affordability-enhancing schemes that might apply between individuals, across savings associations and residential communities, to lower the threshold to ownership and access by historically excluded individuals.

EXPLORE THE SCOPE FOR AND FEATURES OF A DEMAND-SIDE SUBSIDY TO BROADEN ACCESS AND ENHANCE AFFORDABILITY AT THE BOTTOM OF THE COMMERCIAL HOUSING LADDER

A feature of the existing supply-based subsidy regime operated by the Department of Housing is that it does little to encourage the participation of poor households to develop their own housing solutions through incremental incentives or grants to upgrade and improve their housing circumstances. Although this was not a feature of our research, the housing subsidy appears to provide an expensive all-or-nothing solution to the shortage of formal accommodation in South Africa. One interesting option would be to introduce demand-side subsidies which enable households to enter the commercial property market at the lowest level – whether through upgrading or through accessing formal property housing stock. A study of the options and their feasibility would be of great interest to public and private players seeking to broaden access to the bottom of the pyramid.

EXPLORE THE FEASIBILITY AND LIKELY IMPACT OF RATES AND/OR TAX REBATES AS INSTRUMENTS FOR INCENTIVISING THE DENSIFICATION OF URBAN RESIDENTIAL AREAS

The success of UDZ incentives for the development and upgrading of inner-city areas suggests that similar incentives might be considered to facilitate the densification of residential areas. The feasibility and possible application of such measures should be considered, including a comparative assessment of their impact in relation to the likely impact of proposals for inclusionary housing regulations.

EXPLORE THE FEASIBILITY AND IMPACT OF THE REDESIGN AND EXTENSION OF UDZ INCENTIVES TO SMALL BUSINESSES, NGOS AND INDIVIDUALS OPERATING ACROSS ALL PROPERTY SECTORS

Existing UDZ incentives amount to accelerated depreciation allowances. Whilst these work well for large-scale developers with significant tax liabilities, they are less attractive, or do not apply to small businesses or NGOs which might be undertaking significant market-facilitating work. This unnecessarily limits the impact and potential for innovation associated with the incentive. For this reason, it is suggested that the UDZ's existing incentive be converted to a system of tax credit – for all players who can clearly demonstrate upgrading, conversion and improvement outcomes in the urban property space. An investigation (possibly in partnership with the National Treasury and the DOH) might be pursued to explore the scope for dramatically extending the qualifying criteria and application of the UDZ incentive.

EXPLORE THE FEASIBILITY AND RELEVANCE OF APPLYING ESTABLISHED MAINSTREAM INVESTMENT FACILITATION INSTRUMENTS, SUCH AS DEBT SECURITISATION, TO THE LOW END OF THE FORMAL MORTGAGE MARKET

Established financial engineering tools of this nature could contribute to lowering the risks and costs associated with bank lending in these market segments. This research might also identify the extent to which these instruments require or will be enhanced by risk- and cost-sharing financing partnerships between government and the banking sector.

CONDUCT REGULATORY IMPACT ASSESSMENTS OF KEY POLICIES AND LEGISLATION IN PLACE OR IN THE PIPELINE

The alleged burden that key components of existing and proposed legislation and regulation impose on market players and overall property market activity might be explored and quantified with a view to drawing lessons and providing guidance regarding the design of market-compatible policies and regulation. The outcome of such an exercise might be used to justify the establishment of a permanent regulatory impact assessment function within the Department of Housing, to consider the market consequences of all its policy proposals and legislative interventions.

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	Diet van Broembsen	Chief Director
	Anton Arendse	Director: Human Settlement Policy
Department of Land Affairs	Sharmla Govender van Wyk	Deputy Director General
National Treasury	Li Pernigger	Chief Director: NDP Unit
City of Cape Town	Helen Zille	Executive Mayor
	Mansoor Mohammed	Executive Director: Economic, Social Development and Tourism
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	Herman Steyn	
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	Sally Chambers	Legal Advisor: Property Transfers
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	Marty Milne	Manager: Product Development
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	Teddie O Brien	Property Manager
ABSA	Gert Dry	Project Director: Housing Empowerment Finance
Urban Skywalkers	Graeme Reid	Partner
Mathew Nel	CEO	Shisaka Development Mgmt Services

APPENDIX A: SUMMARY OF POLICY AND LEGISLATION

Title	Short Description of relevant sections	Impact on property market
The Constitution	• guarantees existing property rights • mandates the government to enable citizens to gain equitable access to land • everyone has a right to have access to adequate housing • no one may be evicted from their home, or have their home demolished, without an order from the court	• compels the government to be an active player in the market via the housing provision • ensures the provision of affordable housing • secures land/property rights
White Paper on Spatial Planning and Land Use Management, 2001	• sets out the specific responsibilities of the Minister of Land Affairs and the municipalities	• defines various planning functions
Land Administration		
Municipal Finance Management Act, No 56 of 2003	• a municipality may transfer ownership of land, but only after it has considered a fair market value of the asset, as well as the economic and community value to be received in exchange for the asset	• may restrict land from being made available for low-cost housing • ensures efficient market outcomes
Public Finance Management Act, No 1 of 1999	• regulates financial management in the national and provincial governments • ensures that all revenue, expenditure, assets and liabilities of those governments are managed efficiently and effectively	• complicates the disposal of municipal assets/land
Deeds Registry Act, No 47 of 1937	• for the registration of title deeds • applies to all land that houses are located on	• provides formal basis for urban land market
Stamp Duties Act, No 77 of 1968	• requires a stamp duty to be paid on taking out a new mortgage bond	• increases the cost of housing finance
Transfer Duty Act, No 40 of 1949	• imposes a transfer duty on the transfer of property	• increases the cost of buying a house (only applies to property with a value larger than R500,000)
Land Planning and Development		

Development Facilitation Act, No 67 of 1995	• addresses legal uncertainty of land ownership in certain parts of the country • provide nationally uniform norms and standards in relation to land development • mechanism for rapid land delivery	• adds to various options developers have for township developments
Less Formal Township Establishment Act, No. 113 of 1991	• shortens procedures for the designation and development of land and the establishment of townships • provides for the establishment of townships and less formal forms of residential settlement • provides for the use of land by tribal communities for communal forms of residential settlement	• not effective in shortening these procedures • yet another option for township development
Municipal Systems Act, No 32 of 2000	• requires municipalities to prepare Integrated Development Plans for five-year periods • enables municipalities to move progressively towards the social and economic upliftment of local communities	• sets direction for future development • may add a degree of certainty to the market
Housing Delivery and Development		
Housing Act, No 107 of 1997	• housing policy framework • describes the nature and manner of residential settlement development • describes how land should be acquired for housing purposes	
UDZ Tax Incentive legislation (section 13 quat of the Income Tax Act, No 58 of 1962)	• facilitate inner city renewal throughout South Africa by attracting private sector investment in construction, extensions, additions and improvements or refurbishment of buildings in designated Urban Development Zones (UDZ)	• addresses urban decay • provides incentives for inner-city developments • encourages private sector involvement
Other relevant legislation		
Environmental Conservation Act, No 73 of 1989 – as amended by Act 79 of 1992	• Environmental Impact Assessments (EIAs) are required on all land offered for development in response to a land availability call from a municipality	• EIAs slow down development • another approval needed
National Heritage Resources Act, No 25 of 1999	• places development controls on formally protected properties (i.e. national heritage sites) as well as generally protected properties/areas	• delays and possibly restricts development

Expropriation Act, No. 63 of 1975 and its Amendment	• allows for the expropriation of any property for public purposes – under specific circumstances	• distorts the market with interventionist policies • increases uncertainty
National Credit Act, No.34 of 2005	• applicants for mortgage finance must now complete an affordability assessment to prevent reckless lending	• prevents reckless lending
Public-private sector agreements		
Property sector charter	• prescribes the implementation of Broad-based Black Economic Empowerment in the property market	• attempts to eliminate obstacles that restrict the ability of black people to own property
Financial sector charter	• facilitates movement towards black economic empowerment (BEE) in the financial sector	• commitment to extend mortgage financing to the charter market (LSM 1-5)
Tenant-landlord relationships		
Prevention of Illegal Eviction from and Unlawful Occupation of Land (PIE) Act, 1998	• an unlawful occupier may only be evicted on the authority of a court under very limited circumstances	• may make it more difficult for tenants at the lower end of the market to rent, because of increased screening & control
Rental Housing Act, No 50 of 1999	• mandates government to promote a stable and growing rental housing market to provide affordable rental housing for previously disadvantaged and poor individuals specifically • allows for a rental housing subsidy • establishes a Rental Housing Tribunal	• facilitative intervention that could smooth the working of the rental housing market
Proposed Legislation / Interventions		
Land Use Management Bill, 2006	• defines the roles and responsibilities of each tier of government in the planning system • provides for the structure and content of spatial development frameworks (SDFs) and mandates their inclusion in municipal IDPs	

Social Housing Bill, 2006	• defines Urban Restructuring Zones and sets down a number of principles which must be applied in delivering social housing within URZ's	
Inclusionary housing policy	• to promoting greater social inclusion/integration and to break the highly segregated features of the current built environment	
HDA Bill, No. 1 of 2008	• establish a Housing Development Agency to facilitate the acquisition of land • the Agency will assist municipalities to 1) complete projects, which have not been completed (blocked projects); 2) upgrade informal settlements; and 3) deal with emergency housing solutions	

APPENDIX B: POLICY AND LEGISLATIVE DETAIL

As a means of aiding the reader of the text, the more descriptive detail of key policies and legislation have been placed in this annexure.

1. CONSTITUTIONAL MANDATES

1.1 PROPERTY RIGHTS

Section 25

(1) No one may be deprived of property except in terms of the law of general application and no law may permit arbitrary deprivation of property.

(2) Property may be expropriated only in terms of the law of general application-

for public purposes or in the public interest; and

(4) For the purposes of this section –

the public's interest includes the nation's commitment to land reform, and to bring about equitable access to all South Africa's natural resources.

(5) The state must take reasonable legislative and other measures, within its available resources, to foster conditions, which enable citizens to gain access to land on an equitable basis.

1.2 HOUSING RIGHTS

Section 26

(1) Everyone has the right to have access to adequate housing.

(2) The state must take reasonable legislative and other measures, within its available resources, to achieve the progressive realization of this right.

(3) No one may be evicted from their home, or have their home demolished without an order of court made after considering all relevant circumstances. No legislation may permit arbitrary evictions.

2. LAND ADMINISTRATION

2.1 DEPARTMENT OF AGRICULTURE AND LAND AFFAIRS

The Deeds Registry Act, No 47 of 1937

This Act deals with the registration of title deeds and applies to all land that houses are located on, including old township stock, private stock, incremental stock and informal stock.

Stamp Duty Act No 77 of 1968

This Act requires a stamp duty to be paid on taking out a new mortgage bond.

Transfer Duty Act, No 40 of 1949

This Act imposes a transfer duty on the transfer of property.

2.2 DEPARTMENT OF PROVINCIAL AND LOCAL GOVERNMENT

Local Government Municipal Finance Management Act, No 56 of 2003

The aim of this Act is to secure sound and sustainable management of the financial affairs of municipalities and other institutions in the local sphere of government; to establish treasury norms and standards …

Chapter 2: *Part 2: Cash, investment and asset management*

Section 14

(1) A municipality may not transfer ownership as a result of a sale or other transaction or otherwise permanently dispose of a capital asset needed to provide the minimum level of basic municipal services.

(2) A municipality may transfer ownership or otherwise dispose of a capital asset other than one contemplated in subsection (1), but only after the municipal council, in a meeting open to the public –

has decided on reasonable grounds that the asset is not needed to provide the minimum level of basic municipal services; and

has considered the fair market value of the asset and the economic and community value to be received in exchange for the asset.

(5) Any transfer of ownership of a capital asset in terms of subsection (2) must be fair, equitable, transparent, competitive and consistent with the supply chain management policy, which the municipality must have and maintain in terms of section 111.

Public Finance Management Act, No 1 of 1999

The aim of this Act is to regulate financial management in the national and provincial governments; to ensure that all revenue, expenditure, assets and liabilities of those governments are managed efficiently and effectively…

Section 18

(1) A provincial treasury must –

(c) promote and enforce transparency and effective management in respect of revenue, expenditure, assets and liabilities of provincial departments and provincial public entities.

Section 51

(1) An accounting authority for a public entity –

is responsible, including the safeguarding, of the assets and for the

management of the revenue, expenditure and liabilities of the public entity.

3. LAND PLANNING AND DEVELOPMENT

3.1 DEPARTMENT OF PROVINCIAL AND LOCAL GOVERNMENT

Development Facilitation Act No, 67 of 1995

The aim of this Act is to: 1) speed up the land development process by establishing nationally uniform norms and standards in relation to development; 2) establish legislation to act in parallel to provincial legislation; 3) serve as a more appropriate mechanism for rapid land delivery; and 4) provide for early tenure registration and the formulation of Land Development Objectives (LDOs). LDOs are intended to substitute for the inherited system of structure and guide plans. The LDOs are therefore expected to serve as guidelines for determining future developments and infrastructure expenditure and they should aim to ensure that it is more integrated than has been the

Less Formal Township Establishment Act No, 113 of 1991

This Act provides for: 1) shortened procedures for the designation and development of land and the establishment of townships; 2) the establishment of townships and less formal forms of residential settlement; and 3) the use of land by tribal communities for communal forms of residential settlement.

Municipal Systems Act No, 32 of 2000

This Act provides for the core principles, mechanisms and processes that are necessary to enable municipalities to move progressively towards the social and economic up-liftment of local communities …

Chapter 5: *Part 2: Contents of integrated development plans*

Section 2823

(1) A municipality must undertake developmentally-oriented planning.

(2) The Act must be read with Chapter 1 of the Development Facilitation Act.

Section 3126

(e) a spatial development framework must include the provision of basic guidelines for a land use management system for the municipality.

4. HOUSING DELIVERY

4.1 NATIONAL DEPARTMENT OF HOUSING

Housing Act, No 107 of 1997 (as amended by the Housing Amendment Act, No 28 of 1999; Housing Second Amendment Act, No 60 of 1999; Housing Amendment Act, No 4 of 2001) (inter alia)

The aim of this Act is to provide for the facilitation of a sustainable housing development process; for this purpose to lay down general principles applicable to housing development in all spheres of government.

Part 4: Local Government

Section 9: *Functions of municipalities*

(1) Every municipality must, as part of the municipality's process of integrated development planning, take all reasonable and necessary steps within the framework of national and provincial housing legislation and policy to -

ensure that –

inhabitants of its area of jurisdiction have access to adequate housing on a progressive basis.

(c) identify and designate land for housing development.

plan and manage land use development.

Breaking New Ground, 2004

The policies proposed in *BNG* to address the delivery of 'sustainable human settlements', include:

- enhancing spatial planning, which is currently spread across the national DoH, DLA and DPLG;
- requiring that planning exercises be carried out in a participative manner;
- enhancing the location of new housing projects, which requires;
- accessing well-located state-owned land and para-statal land;
- acquisition of well-located private land for housing development;
- funding land acquisition and development; and
- providing fiscal incentives to support the development of well-located land.
- supporting urban renewal and inner-city regeneration, which requires:
- encouraging social (medium-density) housing;
- increasing effective demand, i.e. an incentive to facilitate access to credit in the income group R3 500 – R7 000.

Urban Development Strategy (1995) and Urban Development Framework (1997)

The aim of the strategy is to set out an urban vision along with seven strategic goals. It provides a perspective on urban realities and strategies to address these realities. Urban settlements are defined in the strategy as follows:

- large metropolitan areas = over 2 million people
- large cities = between 500 000 and 2 million people
- intermediate or medium-sized cities = between 100 000 and 500 000 people
- small cities and towns = populations less than 100 000

Matthew Nell & Associates (2007) note that the strategic interventions proposed in the Strategy are not specifically targeted at land markets. Infrastructure investment is intended to improve spatial inefficiencies and the housing subsidy programme is intended to address access to housing with the provision of secure tenure solutions, which could broadly be considered as market-based. The Framework, however, is more of a policy for implementation, which recognizes the need for land reform. The aim of the framework, which is currently under review, is to:

- explain and analyse the current realities of South African cities, i.e. the inheritance extremely dysfunctional urban areas;
- propose an urban vision by proposing policies and programmes, which will support the development of urban settlements that will be: 1) spatially and socio-economically integrated, free of racial and gender discrimination and segregation, enable people to make residential and employment choices; 2) centers of economic and social opportunity where people can live and work safely in peace; and 3) centers of vibrant urban governance, managed by democratic, efficient, sustainable and accountable local governments in close cooperation with civil society;
- explain the major dilemmas affecting policy choices;
- propose an implementation framework for the operationalisation of strategic goals; and
- propose a programme to monitor and evaluate key elements of the framework.

Housing Sector Plans

Housing Chapters should consist of the following: 1) analysis; 2) strategies; 3) projects; and 4) indicators – target group, spatial location, timeframe for implementation, implementing agencies, capital and operational budget implications and sources of funding

Urban Development Zones (UDZs)

In its explanatory memorandum, it describes that under previous law, the tax depreciation of buildings was generally low, either being nil, 2% or 5%. Moreover, there was no accelerated tax depreciation. Under the new scheme any taxpaying, property owning individual or entity (company, close corporation, trust or partner in a partnership) owning property within a designated UDZ may claim a tax incentive in the form of an accelerated depreciation allowance to be deducted from the UDZ eligible taxpayer’s taxable income.

Application of the Incentive

The deduction is applicable in respect of:

- erection, extension or improvement of or addition to an entire building;

- erection, extension, improvement or addition of part of a building representing a floor area of at least 1 0000 square metres, or
- the purchase of such a building or part of a building directly from a developer on or after 8 November 2005, subject to the requirement that:
    - the developer has erected, extended, added to or improved the building or part of the building representing the floor area of at least 1 000 square metres;
    - the developer has not claimed any UDZ allowance in respect of the building or that part of the building;
    - in case of the improvement of a building or part of a building, the developer has incurred expenditure in respect of these improvements equal to at least 20 percent of the purchase price paid by the first purchaser in respect of the building or part of the building.

Improvement of an existing building or part of a building –

In respect of the improvement of an existing building or part of a building the deductible amounts are equivalent to a 5-year straight-line depreciation allowance or:

- 20 percent of the cost of improvement of the building in the year of assessment during which the building is brought into use by the taxpayer solely for the purposes of trade; and
- an amount equal to 20 percent of the cost in each of the four succeeding years of assessment, provided that the person does not cease to use the building or that part of the building used solely for the purposes of trade.

Erection or extension of or addition to a building -

In respect of the erection of a new building or part of a building or the extension of or addition to an existing building, the deductions are computed as follows:

- 20 percent of the cost of either the erection or extension of or addition to the building in the year of assessment during which the building is brought into use by the taxpayer solely for the purpose of trade; and
- 5 percent of the cost in each of the 16 subsequent years of assessment provided that the person does not cease to use the building or that part of the building solely for purposes of trade.

Eligibility

There are two types of eligibility:

- any individual or legal entity that *owns or purchases property* within the UDZ and invests in new building construction and/or refurbishment of existing buildings *solely for trade purposes including rental of residential property* is eligible for the incentive; and
- first purchasers, i.e. investors who procure newly constructed or refurbished buildings or parts thereof for trade purposes from *bona fide* developers, or registered inner city UDZ building owners.

The incentive is relatively easy to access as it requires: 1) filling in an application form from a designated city council describing the refurbishment or erection to be carried out; 2) submitting building plans to the council for approval; 3) carrying out of the refurbishment or new building construction and then collecting a Certificate of Occupancy and a Location Certificate verifying the property is located within a designated UDZ; and 4) preparing a tax return and filling in a SARS UDZ Claim Form.

The legislation states that one area may be demarcated by each of the following municipalities: Buffalo City, Cape Town, Ekurhuleni, Emalahleni, Emfuleni, eThekwini, Johannesburg, Mafikeng, Mangaung, Matjhabeng, Mbombela, Msunduzi, Nelson Mandela, Polokwane, Sol Platatje and Tshwane.

The Urban Development Zone Tax Incentive as promulgated and amended by the UDZ Tax Incentive legislation (section 13 *quat* of the Income Tax Act, No 58 of 1962 (www.sars.gov.za).

Urban Renewal Zones (URZs)

The aim of the Urban Renewal Zones are to:

- integrate the nodes of the city, e.g. Sandton and Alexandra, through economic and spatial integration;
- enhance the economies of the areas by improving access to services and infrastructure and information; and

- enhance social capital by focusing on crime and violence, education and skills, local economies and the capacity of local institutions.

The programme is made up of eight nodes (www.isrdp.dplg.gov.za), with the largest in the three biggest cities of Johannesburg (Alexandria), Cape Town (Mitchell's Plain and Khayelitsha) and Durban (Inanda-Ntuzuma-KwaMashu or the INK area). The Eastern Cape has Mdantsane in Buffalo City and Motherwell in Nelson Mandela. The Northern Cape's Kimberley has Galeshewe. All of these areas are apartheid townships with high levels of poverty and crime. They all require infrastructural upgrading as well as new housing. The areas typically have few internal economic opportunities and residents have low skills and education.

'Inclusionary' Housing Policy

A draft of the national Department of Housing's 'Inclusionary' Housing Policy presents two models:

1. Voluntary Pro-active Deal-Driven component (VPADD); and
2. Compulsory, but Incentive-Synchronised component (CIS)

Option 1: voluntary pro-active deal-driven approach (VPADD)

This option applies primarily to state-owned land and is based on the setting of non-mandatory goals. Willing partners (i.e. a local authority and a developer) should search out each other and come to a mutually beneficial arrangement around the delivery of an inclusive housing environment through a housing project.

Currently there are a variety of projects, which would be very similar in terms of the outcome. However, future projects under the VPADD model will be carried out much more pro-actively. Local authorities will identify projects[44] they wish to pursue with private sector developers. The municipality will typically bring, e.g. land, guarantees of fast-tracked decision-making arrangements and so on to the party. In return the private sector developer will be required to provide a portion of the units as affordable stock.

Both national and provincial government may also become involved in such projects. National government may provide land via the proposed Housing

[44] The private-sector may also act pro-actively in that it may approach local authorities with projects it has in mind.

Development Agency to be discussed further along in this section. Provinces may also do the same.

Option 2: compulsory but incentive-synchronised approach (CIS)

The CIS option applies primarily to privately-owned land. It also attempts to achieve a win-win outcome by trying to ensure that mandatory requirements are off-set, as far as possible, with appropriate incentives. In particular, the conditions[45] that developers face in carrying out township establishment and fulfilling development control processes may be relaxed. The thinking is that township establishment processes, rezoning and sub-divisions are important carrots and sticks in that they are based on developers receiving approvals before they can proceed with their projects. These approvals may be made contingent on meeting certain 'inclusionary' housing requirements. More specifically, town planning schemes are where specifications as to rights are located, including: 1) usage, e.g. residential or commercial; and 2) building parameters, e.g. height, bulk, coverage restrictions.

The proposal sets out six different types of incentives to encourage developers to provide 'inclusionary' housing:

- tax benefits –
  National Treasury is currently evaluating a range of incentives, including a Tax Credit Scheme. The benefit would be available to all 'affordable housing' providers, not simply 'inclusionary' housing schemes. *One gets the sense that Government is not entirely convinced that the Department of Housing's proposal is the approach to follow if it is exploring a purely tax credit scheme at this time.*

- land –
  State land could be used to underpin the deal-driven option (VPADD); the national DoH has also been mandated to establish a Housing Development Agency to acquire, assemble and provide land for housing development, including 'inclusionary' housing - this initiative is fully explored in the next section. Suffice to say that at this point in time, developers do not care how

[45] Processes governing township establishment include: local planning ordinances, town planning schemes, zoning/rezoning, development approvals and subdivision approvals. Noteworthy is the fact that these processes vary from province to province and so the application of them will also vary, until, e.g. the propopsed Land Use Management Bill is passed.

state land is made available to them as long as it occurs rapidly, efficiently and is affordable.

- fast-tracking of approval processes –
  This incentive would be available in cases of the deal-driven option (VPADD) being pursued, however, due to the slow-down that is occurring in approval processes throughout the country, it raises a very real concern as to what will happen to applications that are not fast-tracked. Concern has been raised that they will simply disappear into the bowels of the municipalities.

- development and use rights –
  Such rights would manifest as density bonuses/allowances and in certain instances land use rights. One would assume that bonuses and allowances would be attractive to developers, however, the question is really whether local authorities will want to forgo the maximum value of the assets they have built up over time to provide ‘inclusionary’ housing to low-income people? This incentive raises a number of trade-offs that each municipality will have to make for itself.

- bulk and link infrastructure –
  As a rule developers negotiate with local authorities as to who will provide bulk and link infrastructure to projects and they are generally expected to contribute to these costs. Depending on their circumstances, each local authority will be looking to cover the cost of new development from a variety of sources, and so will only be willing to relieve developers of this cost if they have another source on hand to replace it.

- access to government housing subsidies
  There are currently a number of factors which affect the number and type of subsidies a local authority will be able to access. In fact, at this time the bulk of housing subsidies are going to upgrading informal settlements and rectifying shoddily built houses. The mega-projects being carried out around the country are also able to attract subsidies.

  Developers operating outside these parameters are highly unlikely to be able to access government subsidies, which could be very important in determining how successful the ‘inclusionary’ housing intervention will be, because they off-set the cost of the low-income houses being delivered. Hence, even if all local authorities formulate 'Inclusionary' Housing Plans, the fact that they receive very limited numbers of subsidies from national and provincial government means that even if most developers prepare new applications which include 'inclusionary' housing, they more than likely will not be able to access housing subsidies. Will local authorities then hold up development of higher-income housing until subsidies are available for 'affordable' housing? And what happens if it takes years before subsidies become available?