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Research Report on Deferred Ownership: Exploring possibilities for ownership opportunities in the gap market utilising early subsidies for properties sold by instalment sales or lease option

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TABLE OF CONTENTS

LIST OF TABLES

LIST OF FIGURES

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DEFINITION OF TERMS

Affordable housing market: The segment of the housing market that services households in the gap and subsidy market. Often the market is defined as containing properties of a value no more than R600 000.

Agreement: An instalment sales agreement.

Arm's-length model: Form of early subsidisation in which government subsidises an external entity who supplies the housing unit in order to provide a loan or an option to the individual beneficiary.

Aspirant buyer: A buyer in the lease stage of the lease option agreement who thus still needs to generate finance to take up the option to purchase.

Bank guarantee: From a lending institution, ensures that the liabilities of a debtor will be met.

Beneficiary: A beneficiary refers to someone that has been approved for a housing subsidy. To be approved, a beneficiary has to be selected for a project, meet the eligibility criteria for the grant and given an approved status on the Housing Subsidy System (HSS).

Bond approval: The process whereby financial institutions approve applications for mortgages from prospective property buyers or existing owners.

Bond: A deed in which one person is committed to make payment to another. In South Africa, often used interchangeably with a mortgage.

Building control: A municipal function which entails checking that buildings meet the local standards as given in the Land Use Management System and the applicable standards given in the National Building Regulations and Buildings Standards Act, 103 of 1977. The function sometime entails providing advice to property owners about how they can better comply with standards.

Buyer: Instalment sales buyer.

Cadastral boundaries: The precise geographic boundaries of an erf as recorded by the Surveyor General and the Deeds Office and enforceable by law.

Contract: An instalment sales agreement.

Conveyancer: An attorney with additional qualifications who has been admitted by the High Court as a conveyancer and is thereby, as part of his authority, qualified to prepare and lodge transfer documents in the Deeds Office and to register the transfer of ownership of land in the Deeds Office.

Deceased estate: All the fixed and movable assets which belonged to a deceased person.

Deeds Office: The government agency in which the registrar's functions include maintaining records for all land registered in his or her area of jurisdiction, registering grants or leases of land issued by government or another authority, executing and registering deeds of transfer of land and certificates of title to land.

Deeds Registry: The Deeds Office of that particular jurisdiction.

Deferred ownership: A form of tenure in which an occupant (or buyer) is given occupation rights to a property with an undertaking from the landowner (or seller) that if certain conditions are met, full ownership will be provided to said occupant.

Department: The Western Cape Provincial Department of Human Settlements (WCDHS).

Developer: A person or company that purchases raw land, constructs and/or renovates buildings and sells developed land. The developer coordinates these activities, which can also include managing the construction process, where he/she is responsible for the financing and oversight of construction and is the accountable authority for every aspect of the construction project.

"Dignified exit": A low-cost exit to a credit agreement, allowing a buyer to retain capital contributions and gains while the seller receives compensation for the capital still owed and arrears.

Direct model: Form of subsidisation where government itself is the supplier of the housing unit as well as the loan to the individual beneficiary.

Dispute resolution: A set of processes for resolving disputes between parties including mediation and adjudication. Dispute resolution is usually run by bodies or parties who are independent of parties directly implicated in the dispute.

Encumbrance: A burden, obstruction, or impediment on property that lessens its value or makes it less marketable; any right or interest that exists in someone other than the owner of a property and that restricts or impairs the transfer of the property or lowers its value, e.g. a mortgage.

Finance Linked Individual Subsidy Programme (FLISP): A housing subsidy for first-time home buyers to assist with purchasing a house. Mortgage linked, i.e. paid to bank/financial institution providing mortgage loan.

Gap market: The housing market defined by household income, where households have incomes above the income eligibility threshold for a full subsidy but below the income at which households can afford to supply their housing needs through normal market processes unaided by subsidy.

Greenfields project: A project developed on an open, unoccupied site.

Housing affordability: The financial ability of a household to purchase a house. Beside income, the factors which impact this include the prime lending rate, the risk premium charged on prime, the period of the loan as well as the share of debt currently faced by the household. The availability of housing stock will also impact on affordability.

Housing Code: The set of rules governing how each of the housing subsidy types must be applied.

Housing Subsidy System (HSS): A national information system administered by Provincial Human Settlement Departments which records the outcome of particular project approval and subsidy approval stages for each subsidy project and/or instance in which a subsidy instrument is used and the expenditure against different project and subsidy items for each project or instance for which an instrument is used.

Informal sale: An agreement between a buyer and seller, both private individuals (i.e. not government), that is deemed to be complete by the parties, but does not result in the transfer of ownership from seller to buyer being registered in the Deeds Office.

Instalment sale: A capital repayment arrangement whereby the occupant of a unit pays for the unit over a period of time. No collateral is paid by the occupant and payments include capital, interest and rental payments. Transfer occurs once the unit is paid for.

Latent defect: A material defect which was not visible after reasonable inspection.

LAWSA: The Law of South Africa, a comprehensive encyclopaedia of South African law.

Lease option: An agreement in which the person renting the property has the option to buy it at a pre-set price after a certain period.

Lease purchase: Similar to lease option, except that the buyer is legally required to purchase the property at a pre-set price and can be sued even if the they cannot raise finance to make the purchase.

Lien: A legal claim on an asset. As part of the mortgage process, a lien in favour of the mortgage loan giver (e.g. bank) is placed on a property. Even though the property belongs to the buyer, the proceeds of any sale should first go to paying off the loan and any arrears. To safeguard the loan provider's preferent right, the lien holder must release the lien before any sale (to a third party) can occur.

Lower-gap housing market: The lowest segment of the gap market. Currently households earning between R3 501 and R7 000 per month are seen as the lower-gap market.

Market penetration: The extent to which members of a market buy or use a product**.**

Mortgage loan: The legal agreement by which a bank, building society, etc. lends a buyer money at interest in exchange for taking title of the buyer's property, i.e. the lender puts a lien on the property and has the right to sell it (i.e. foreclose on the property) if the buyer defaults on the mortgage loan obligations; also known merely as a mortgage.

Non-qualifier: A household that does not meet the qualification criteria laid out in the Housing Code and is therefore ineligible to own property via a government housing subsidy.

Patent defect: A flaw that is not hidden and ought to be easily identified upon reasonable inspection.

Performance: In a contract, performance is deemed to be the fulfilment of an obligation, in a manner that releases the performer from all liabilities under the contract.

Personal right: A right entitling a person to claim something or some act from another person which is only enforceable against that other person, e.g. the right arising out of a contract which would include the right of a purchaser to claim the registration of the transfer of ownership of the subsidy property purchased in terms of a deed of sale.

Pre-emptive clause: The provisions in section 10A and 10B of the National Housing Act (107 of 1997) which requires that all property transfers arising from subsidies be subject to restrictions on their resale lasting for eight years from when the subsidy properties were acquired by the subsidy beneficiaries, and further restricts the sale of properties created through subsidies by the creditors in law or the successors in title of the original beneficiaries for the remaining period of the eight years from when the original beneficiaries acquired the property.

Preferent claim: As opposed to concurrent claim.

Qualifier: An individual who meets the Housing Code qualification criteria and is thus eligible to own property via a government housing subsidy. Whether an individual meets the eligibility criteria depends on the structure of the household of which he or she is part: the individual may require a spouse or a co-habiting partner to qualify. Where the individual has a spouse or co-habiting partner and is approved as a beneficiary, the spouse or co-habiting partner becomes a co-beneficiary and co-owner of the subsidy property with the individual.

Real right: A right that becomes real upon registration. A real right entitles the holder thereof to enforce or vindicate the right for him- or herself against "all the world". The personal right to take transfer that arises from a deed of sale becomes real upon registration of the transfer in the Deeds Office.

Reckless credit: Credit granted to a consumer under a credit agreement that leads to the consumer becoming over-indebted, i.e. a consumer is unable to meet their financial responsibilities or pay their accounts on time according to their credit agreements.

Registration of title: The process whereby the Deeds Office recognises a transfer of ownership associated with a plot as valid and adds the record of the change of ownership to the Deeds Registry.

Registrable: In relation to land, means capable of being registered as the subject of a separate title deed in the Deeds Registry.

Registrability: The condition of being registrable.

Rent with an option to buy: An agreement in which the prospective owner (buyer) rents the property for a period from the current owner of the property (seller) and then has the option to buy the property at a price set in the agreement after that period has lapsed.

Sales Agreement (also referred to as a Deed of Sale): The written contract between the seller and the buyer recording the sale of a subsidy property. The contract records i*nter alia* the seller and the buyer, the identity of the subsidy property being sold and the purchase price as well as any other condition and/or special conditions such as restrictions on the use of the land.

Scale economies: The cost advantages that enterprises obtain due to size, output, or scale of operation, with cost per unit of output generally decreasing with increasing scale as fixed costs are spread out over more units of output.

Seller: The agency who is administering the sale of the property; synonymous with owner of the property here. In the case of an instalment sale, the seller provides a loan to the buyer.

Subsidy quantum: The monetary amount made available by a subsidy instrument to provide a housing opportunity as defined in the Housing Code.

Suspensive condition: A condition inserted into an agreement to protect either the Seller or the Purchaser, which suspends the rights and obligations contained in the contract until the happening or not of a future event (usually linked to a time period).

Tenure status: The legal status of a person is the degree to which the person has right to use, control and transfer the property which he or she occupies, and the restraints and responsibilities related to that property. Ownership gives a person the highest rights to use, control and transfer the property.

Title: Registered ownership of an immoveable property.

Transfer: A transfer of land registered in the Deeds Office.

Transferee: A person or persons to whom immoveable property is transferred.

Vacant possession: Where a buyer has exclusive use of the property they have bought, the previous occupant having moved out.

Voetstoots: Without guarantee or warranty; at the buyer's risk.

Warranty: A written guarantee, issued to the buyer of a good by its manufacturer or another authority, promising to repair or replace the good if necessary, within a specified period of time.

Would-be buyer: Someone applying for an instalment sale or lease option.

ABBREVIATIONS

ALA	Alienation of Land Act 68 of 1981
AN	Amakhaya Ngoku
CCG	Consolidated Capital Grant
COGTA	Department of Co-operative Government and Traditional Affairs
CPA	Consumer Protection Act 68 of 2008
CTCHC	Cape Town Community Housing Company (Pty) Ltd
DFI	Development Finance Institutions
DORA	Division of Revenue Act
FLISP	Finance Linked Individual Subsidy Programme
HAB	Housing Association of Blaauwberg
HSS	Housing Subsidy System
HSDG	Human Settlements Development Grant
ISA	Instalment Sales Agreement
MFMA	Local Government: Municipal Finance Management Act 56 of 2003
NCA	National Credit Act 34 of 2005
NCR	National Credit Regulator
NHBRC	National Home Builders Registration Council
NHFC	National Housing Finance Corporation
NDHS	National Department of Human Settlements
PAJA	Promotion of Administrative Justice Act 3 of 2000
PIE	Prevention of Illegal Eviction from and Unlawful Occupation of Land Act 19 of 1998
WCDHS	Western Cape Department of Human Settlements
SHRA	Social Hosing Regulatory Authority
SOHCO	Social Housing Company
SPLUMA	Spatial Planning and Land Use Management Act 16 of 2013
TRA	Temporary Relocation Area

EXECUTIVE SUMMARY

The government's Finance Linked Individual Subsidy Programme (FLISP) currently provides subsidies to enhance affordability in the gap market via what can generally be called a household income-based mortgage deposit subsidy. Qualifying households in the gap market require an approved mortgage to obtain the subsidy. Broadly speaking, the subsidy, mortgage and any lumpsum contribution of the beneficiary is used to finance the sale. Full freehold ownership is transferred to the beneficiary upon sale.

The main research question considered in this report is whether the gap market can also be effectively supported by the subsidisation of deferred ownership, in which **the subsidy is provided early in the deferred ownership sales process**. Currently, the FLISP subsidy can only be used at the point when a deferred ownership arrangement shifts to a full ownership arrangement, i.e. **relatively late in the process**, when the unit transfers to the buyer and is held in freehold tenure.

This report considers two deferred ownership instruments: instalment sales and lease option. In an **instalment sale**, the prospective owner (the buyer) enters into an agreement with the seller (usually the owner of the property) to buy the unit in instalments over a defined period, the maturity period of the agreement. During the instalment payment period, the buyer takes occupation of the property and can enjoy all the rights of use of the property, while the owner retains legal title as security until the buyer pays in full. A **lease option** agreement is sometimes referred to as rent with an option to buy. The buyer enters into an agreement with the seller to rent the property for a period and upon completion of the lease period has the option to buy the property at a price set in the agreement. The seller usually charges the buyer an option fee.

1 Rationale for deferred ownership

The rationale for deferred ownership arises from the benefits the arrangement may be able to offer in comparison to a mortgage-financed outright sale. First, deferred ownership may allow mortgage providers greater access to property markets they see as risky by funding sellers, rather than buyers. The theory is that deferred ownership broadens financial access because the seller retains real rights. Second, in a lease option agreement, the lease period creates the space for aspirant buyers to improve their credit readiness and thus access finance for the sale. Third, the cost of entry and exit is reduced by lower transaction fees, allowing non-performing buyers to easily exit and new ones to enter, thereby creating easy remedies for buyer non-payment. Fourth, the buyer can experience capital gains during the lease and/or loan period, and thus benefit from property market participation without having to own property.

2 Risks associated with deferred ownership

The benefits, however, need to be weighed against the risks. There are several well-known risks associated with deferred ownership arrangements because the seller retains real rights to the property, while the buyer only has personal rights to receive ownership in the future subject to an agreement. The international literature has tended to focus on the risks faced by buyers, but risks are also faced by sellers.

Instalment sales buyers face the risk of the seller selling the property to others; not transferring the property to the buyer when the loans have been paid off; losing maintenance and upgrading investments in the property during the loan period; and losing capital contributions and capital gains should buyers have to withdraw from the agreement or the seller's creditors attach or foreclose on the property. Sellers face the risk of non-payment and, depending on the eviction regime, getting vacant possession of the property. Sellers also must sustain their businesses for extended periods because of the long-term relationships with buyers, during which they are required to keep loans affordable and constantly have to expand their businesses to maintain economies of scale. In sectional title schemes, both buyers and sellers face the risk of body corporates failing and levy non-payment, and the loss of capital that arises from the physical decline of property due to lack of maintenance.

Lease option buyers face greater risks that arise from their weaker claims over the property during the lease period compared to buyers in a loan agreement. Risks are heightened if participation costs are high, the option fee becomes part of the sales price, and aspirant buyers have to obtain finance to take up the option. Sellers can more easily renege on the sales agreement at the end of the lease period. Sellers face non-payment risks, which are heightened when the courts are unclear about the nature of lease option agreements and the eviction regime is heavily tilted in favour of the lessee.

3 Risks associated with the supply of subsidies in deferred ownership settings

The provision of early government subsidies in the development process gives rise to two risks: **leakage to non-targeted households and markets** and the **creation of lower-grade benefits or benefits that continue to incur cost for the government**, tying up resources that could have been used to supply additional benefits.

Government subsidisation can occur in two broad models. In a **direct supply model**, the government develops units, using its own financial resources, and becomes the seller, either renting out the unit before selling it to the beneficiary outright if the rental period proves successful, or selling it in instalments to the beneficiary from the beginning of the agreement. The sales price is the cost of the unit discounted by the relevant subsidy amount and could be further reduced by hidden subsidies. If the capital is grant-funded, government may be able to provide the loans to the buyer at zero interest. Given all the subsidies which tend to get locked up in direct supply models, failure of such schemes is likely to give rise to substantial leakage. Furthermore, stemming leakage in such schemes is dependent on recovering non-targeted subsidies from beneficiaries. The government, as a direct supplier, has an extremely poor track record of collecting beneficiary contributions and recovering costs.

In an **arm's-length model**, the government provides subsidies to third-party developers which could take many forms, including for-profit companies or non-profit agencies independent of government. The provision of subsidies is more deliberate and transparent and likely to be more controlled, lowering the risk of leakage.

4 A Normative Framework for managing risks

A broad **Normative Framework** is developed here to address the risks identified. Government regulation, the agreements between sellers, buyers and financiers and the rules of government subsidies should be addressed in the following risk management objectives:

- **Buyer risk management objectives**: holding some kind of security over the property purchased; retaining capital stakes and benefitting from capital gains upon withdrawing from the agreement; assuring quality of the property purchased; taking on responsible debt to purchase the property; gaining successful transfer of the property.

- **Seller risk management objectives:** enforcing payment within a balanced eviction regime; avoiding political interference; retaining the value of capital before transfer; creating legal certainty and building the competence of the court; clarifying property tax liability; having clear and stable rules for subsidised developers; retaining the ability to select buyers; ensuring economies of scale and diversity of funding; preserving value in medium- to high-density private developments with shared areas/facilities.

5 Breaking the research question down into sub-questions and research methodology

The key question is broken down into four sub-questions:

a) Does deferred ownership have distinct benefits over outright sale?
b) Can the risks of deferred ownership generally be managed?
c) Should projects and initiatives take a direct supply form, or should the arm's-length form be retained as the only form of supply?
d) At what point in the deferred ownership project cycle should an early subsidy occur?

These questions are answered by, first, laying out key aspects of the regulatory framework in South Africa, especially as they relate to the protection of the buyer. Second, several case studies are undertaken. The Institutional Housing Subsidy Programme provides the opportunity to consider how instalment sale and lease option agreements have been used in a subsidised environment in South Africa, whether buyer and seller risks have been adequately managed, and what outcomes are likely. Several new privately funded initiatives are also considered. The outcomes and findings of case studies are considered in a separate section, the latter making use of the Normative Framework. Quite a few risk management lessons can be derived. Answering the questions has led to a set of recommended policy and research actions in the concluding chapter.

6 Regulatory framework in South Africa

On the side of the buyer, the regulatory framework in South Africa is relatively complicated and provides good protection, especially for instalment sales buyers. First, the Alienation of Land Act (ALA) addresses buyer risks quite thoroughly and focusses on securing the buyer's rights to the asset he/she is purchasing via the instalments. Requirements that the property be registrable, and the agreement be recorded in the Deeds Office are strict. The former wards against delays in timeous eventual transfer of the property to the buyer, while the latter prevents the sale of the property to other buyers and activates the preferent right afforded buyers where the property is encumbered. The ALA also protects the buyer's capital stake and gains in the property should the ISA be cancelled.

Second, the National Credit Act (NCA) gives relatively effective protection to buyers against being granted reckless credit and stops creditors from making short-term gains based on entry fees, penalties and high interest rates. Credit needs to be affordable to borrowers and borrowers should have an adequate history of managing their debt successfully.

Third, the Consumer Protection Act (CPA) provides protection to buyers from poor building quality. Building quality is defined through the concept of the fitness for purpose. The Act gives rise to an "implied warranty" on the property, i.e. that the property is fit for purpose and has no defects. However, it is uncertain whether the buyer is adequately protected from entering into an agreement for a property with defects, as the relevant provision is not applicable if the consumer was informed of the specific condition of the product, yet still accepted it.

7 Case studies

Categorisation	Case study	Broad description of project/s
Institutional Subsidy, instalment sale	Cape Town Community Housing Company (CTCHC)	Legacy Projects (9 projects built in 2001/02 with 1571 accounts settled to date out of 2460 built). Newer Projects (4 projects constructed between 2004 and 2015/16 with 423 accounts settled out of 1519 built). The Housing Institution developed the property, became the landowner, financed development through the housing subsidy, a range of other subsidies and a loan from a government owned DFI (NHFC), that eventually became the CTCHC's sole owner. Evolved its instalment loans, which were initially unaffordable, to become more mortgage-like in terms of interest rates and maturity periods over time. Legacy Projects wracked by buyer non-payment problems and perceived quality problems and "political interference", leading to operational losses for the NFHC, despite substantial additional subsidies to "rectify" buildings. Suffered a devastating loss of a Constitutional Court case brought by certain buyers, which has led to further financial losses. The Court found that the CTCHC did not record their ISAs according to the ALA. All instalment payments made up until 2014 must be counted as capital repayments.
Private, instalment sale	Chartwell Housing Finance Solutions (Chartwell)	Established its property investment business in 2016 to buy property in bulk from property developers who were often commissioned to build units; financed by a single source - a large international state pension fund - without the use of mortgages. Currently serving the upper-gap market and somewhat higher. Instalment loans structured like a mortgage, but with monthly payments including significant "recoverable amounts" mainly to recover sectional title levies; no upfront payments required.
	Sentinel Homes (Sentinel)	Established instalment sales business in 2018 to mainly buy existing secondary market units for resale via instalment sales upon application from buyers; financed by a bank providing a facility secured by mortgages on the properties bought by Sentinel. Currently servicing upper-gap market somewhat and higher Instalment loans structured like mortgages with similar upfront payment to cover Sentinel's transaction costs in buying the property for on-selling via instalments; buyer required to pay 5% loan deposit upfront.

Institutional Subsidy, lease option	Social Housing Company (SOHCO)	Sectional title development commenced in 2000 resulting in the construction of 224 units embedded within 374 long-term rental units financed by the housing subsidy, donations and loan with the NFHC. SOHCO scaled back initial target of 500 lease option units in the light of non-payment risk and risks associated with sustainability of body corporates. Sustained affordability through donations and by keeping sales prices nominally constant over construction and sales period. Focussed on construction quality issues to avert on non-payment problems. Buyers able to access relatively small mortgages due to high market value of units and economies of scales due to high local demand at the bank branch level.
	Housing Association of Blaauwberg (HAB)	Project commenced in 2000 and, by 2007, 676 houses built but only seven transferred; financed by housing subsidies and an NHFC loan. Project was beset with building quality problems, non-payment and registrability issues. HAB declared insolvent in 2010 after the NHFC sued for bankruptcy having suffered significant losses; property eventually transferred to the City with no compensation given to the NHFC; City seeking to transfer to beneficiaries after the registrability and quality issues have been addressed. City expects no cost recovery from buyers.
	Amakhaya Ngoku (AN)	Community-based institution set up in 2007 to provide sectional title units to an informal settlement pocket on a municipal site following a shack fire; financed by housing subsidies and substantial donations. A total of 232 out of a target of 352 units built and occupied, but none transferred to aspirant buyers. Rents kept low with the option fee sales price set to zero. Project failed following wide-spread non-payment of rent, a collapse of the AN Board and protests by subsidy "non-qualifiers" who refused to vacate the site, causing construction to stop and a halt to the operations of the Board in 2013.

8 Answering the research questions

First, deferred ownership does have some distinct benefits over outright, mortgage-financed sales, although these are rather muted. There is some limited evidence that mortgage financiers are moving into upper-gap property markets previously considered too risky using deferred ownership mechanisms. The Institutional Subsidy experience shows that banks will only enter where units are heavily subsidised and are experiencing high capital gains. Limited evidence was gathered to suggest that lease periods do facilitate greater buyer credit readiness. The explicit costs of entry and exit do seem to be generally lower; however, in cases where private companies buy units for on-sale via deferred ownership mechanisms, they tend to pass on all the same transaction costs faced by buyers in mortgage-based outright sales. However, in private schemes there is no evidence to suggest that lowering costs of entry enhances the affordability of the unit as private schemes often have monthly recoverable amounts in addition to the loan instalments. Evidence suggests that buyers in subsidised schemes have experienced capital gains in projects over the last 20 years, but this is likely to have been underpinned by high levels of subsidisation. It is still too early to know whether buyers in new generation private schemes have enjoyed capital gains.

Second, it does seem that with sufficient effort, the buyer and seller risks can be addressed, although there are some circumstances that should be avoided altogether. Buyer capital risk in instalment sales can be well managed through compliance with the ALA by all parties, although it is not clear whether the same risks can be managed in lease option agreements through regulatory adherence. Risks of non-payment can be lowered if sellers take building quality issues seriously, politicians refrain from interfering in projects, and subsidy beneficiaries are given a real choice about participation in such schemes, as they must be willing to pay the contribution required. Sellers need to have the discretion to select their buyers. "Dignified exit" mechanisms, through which buyers can retain their capital contributions and any capital gains as well pay off any instalment arrears, must exist. Sellers can institute a few measures to lower the risk in sectional title schemes including mixing ownership units with long-term rental units. Sellers can make use of a range of mechanisms to ensure that an adequate quality of building, including subjecting themselves to the full range of building inspection processes available.

Third, to date, no direct supply models have been implemented in South Africa. There are several regulatory hurdles that need to be cleared, including getting permission from national authorities that grant funding can be used by government to provide instalment loans. The biggest danger is that such schemes would be wracked by crippling buyer non-payment. If non-payment is a significant problem even in arm's-length subsidised projects, how much more of a problem will it be in directly run projects? Rental schemes run directly by the government show chronically low collection rates that have persisted for some time, despite strong efforts to improve building quality. Non-payment will mean government cannot recover construction and operating subsidies locked into these schemes for higher-priority subsidy programmes, and has negative financial, environmental and governance consequences for host municipalities, and undermines fairness in the subsidy system as a minority of gap market households capture significant subsidies.

Fourth, in the light of the evidence that buyers face significant building quality risks or are likely to perceive building quality as poor if they are not given choice over the unit they purchase, subsidies provided early should not be used as developer subsidies. Rather, subsidies should be transferred into the loan accounts of beneficiaries in much the same way that a FLISP subsidy is. Such a scheme could only be extended to lease option agreements after the lease period is complete and the option to purchase can be taken up by the buyer.

9 Recommendations

Several policy and research actions are recommended:

- Retain the "arm's-length only" approach to subsidising deferred ownership units.
- Facilitate compliance with all consumer protection legislation, including the ALA.

- Recognise emerging new private companies providing instalment sale loans in their own developments or for properties they have purchased as a building block for new subsidisation policy, rather than building new housing institutions.
- Investigate providing FLISP subsidies to buyers purchasing properties from these new companies only at the point that the physical unit is available and registerable. The investigation should be done as part of considering whether to extend the FLISP subsidy into a range of non-mortgage loans, e.g. pension-backed and unsecured loans.
- Do not provide early subsidies for lease option during the lease period, as it is a test period to improve the creditworthiness of the aspirant buyer and appears to hold significant risks for the aspirant buyer. There are practical constraints regarding this funding mechanism if the seller, rather than the buyer, is to be subsidised.
- Explore a range of mechanisms for improving creditworthiness and signalling improvements other than through a lease option, given the dangers involved with the latter.
- Retain the current FLISP arrangements for the late subsidy of deferred ownership, i.e. FLISP approval and payment at the point of transfer into full ownership. Late subsidisation of deferred ownership agreements carries the same risk as subsidising mortgage-financed sales, which is widely seen as acceptable.

1 INTRODUCTION

The government's Finance Linked Individual Subsidy Programme (FLISP) currently provides subsidies to enhance affordability in the gap market via what can generally be called a household income-based mortgage deposit subsidy. Qualifying households in the gap market require an approved mortgage to obtain the subsidy. Broadly speaking, the subsidy, mortgage and any lumpsum contribution of the beneficiary is used to finance the sale. Full freehold ownership is transferred upon sale.

This report grapples with the question of whether the gap market can also be effectively supported by the subsidisation of deferred ownership, in which the subsidy is provided early in the deferred ownership sale process in housing projects.

In a deferred ownership arrangement, the property to be owned is occupied and used by the prospective owner for an extended period before full ownership is achieved and key elements of sale and payment arrangements for eventual ownership are established and agreed upon by the buyer and current owner (or an intermediary[1]) before occupation. Compared to the sale of property for immediate ownership, the transfer of property via deferred ownership mechanisms may have certain advantages, depending on the details of the mechanism. A key benefit is that the price of property is established and locked at the time of the agreement, before full ownership is achieved, which, if the market performs above expectations, provides the buyer with capital gains. Second, if outright sale is deferred for a set period at a target price, the interim period provides the prospective buyer with a period in which they can prepare their finances in a setting in which the goals and rewards of such sales are more clearly manifest (compared to a normal savings situation). The context is thus arguably more incentivized than that in which the use of the property to be bought is gained through outright sale. In a deferred situation where the buyer progressively pays-off the property to the current owner (termed "an instalment sale"), certain administrative fees associated with outright sale can be avoided until much later in the process, lowering the costs of entry into ownership, at least in the short- to medium-term, when finances for the buyer may be constrained. Administration fees related to the outright sale include bond and title registration processes and can be substantial. Furthermore, the buyer is freed from accessing third-party finance. Last, and perhaps most importantly, the ownership by the loan provider of the property being financed inverts the arrangement in a normal mortgage-funded sale (in which the loan provider does not own the property outright, but has certain rights over it) and may change the balance of risks which may allow sellers to access riskier markets. Financial access could thus be enhanced or broadened through deferred ownership arrangements and associated fees lowered for the buyer.

There are, however, several well-known risks associated with deferred ownership arrangements, as the seller retains real rights to the property, while the buyer only has personal rights to receive ownership in the future, subject to an agreement. Buyers are sometimes said to have "equitable title". In the case of instalment sales, for instance, the seller may go insolvent and creditors may have claims on the property that are concurrent in relation to the buyer. In several contexts around the world, deferred ownership arrangements are regulated to ensure that buyers are not disadvantaged. Sellers also face risks, several of which may arise from government regulation; one

[1] For the paper, owner and seller are considered synonymous, and arrangements involving intermediaries and "remote" buyers are not considered.

of the key risks for sellers is getting vacant possession of the property should buyers not meet their payment obligations. Evicting buyers may be costly and time consuming. Given the imbalance in rights, both parties may face losses in relation to the maintenance of the property.

This report grapples with the question of whether the gap market can also be effectively supported by the subsidisation of deferred ownership, in which the subsidy is provided early in the deferred ownership sale process in housing projects. Currently, the FLISP subsidy can only be used at the point when a deferred ownership arrangement shifts to a full ownership arrangement, i.e. when the unit transfers to the buyer[2] and is held in freehold tenure. Thus, for instance, if a prospective beneficiary is renting a property with an option to buy it at a point in time, the subsidy can only be provided when the household raises a mortgage to buy the property outright. Likewise, if the household is buying the house in instalments from the seller, only at the point where the subsidy is used as the final instalment to buy the house outright or the instalment sale is converted into a mortgage-financed sale, can the FLISP subsidy be provided. In a deferred ownership sale, can the subsidy be provided earlier than at the point of outright transfer of the property into the name of the buyer?

Providing a subsidy earlier in the process for units that are not transferred to the beneficiary poses significant risks for government. Two broad contexts exist for early subsidisation: an **arm's-length model**, in which the government subsidises an external entity who supplies the unit, to provide a loan or an option to the individual, and a **direct model,** in which the government itself is the supplier of the unit and the loan to the individual. In an arm's-length context, if the subsidy is used as developer finance, the units may not get built if the developer is not properly financed or mismanages the construction process, or the units may come in at higher than estimated costs, putting prices beyond the target subsidy market. In both arm's-length and direct contexts, if subsidy beneficiaries fail to make the required contributions in rents or instalment contributions or fail to take up options to buy, the objective of ownership will not be reached. The subsidised asset may "leak" to households outside of the target group or the seller may be put under financial pressure as running costs (including debt repayments) cannot be covered. Furthermore, government will either have to try to claw back the subsidy (probably at considerable cost) or write it off. In a direct supply context, where government is a landlord, it could face the long-term operational burden of running the schemes as, essentially, subsidised rental schemes, and managing the fallout to surrounding areas if the scheme is not adequately run.

The government does have experience with subsidising deferred ownership early on in the construction process via its Institutional Housing Subsidy Programme run between 1999 and 2017, in which an arm's-length supply approach was generally taken. Where the government was involved (mostly municipalities and development finance institutions (DFIs)), it set up entities that were supposed to be arm's-length in nature. The programme provided capital subsidies to housing institutions for individual, approved households, assembled by the institutions for schemes in which

[2] Buyer usually refers to the party buying the property using a deferred ownership mechanism – so they are either the prospective buyer (in rent with the option to buy situation) or the buyer (where they are buying the property gradually in instalments). The owner is the owner of the property being bought via the deferred ownership mechanism. In the literature, the seller is used to refer to the agency who is administering the sale, and where different from the owner, will be receiving instruction from the owner and be paid for administration services. The terms are often used interchangeably, but here seller is used to mean administration agency specifically, and owner is the preferred general term. Confusion also arises from the term buyer, as the owner may also be in the process of buying or financing the unit they are selling through a deferred ownership mechanism.

construction was funded by the subsidy and loans taken by, or donations made to, the institution. The subsidy provisions provided institutions with two main options to recover the costs from the beneficiaries: the institution could rent out the units to beneficiaries with an option to the buy the unit outright after four years with the option fee set to zero. Alternately, the institution could sell the unit to the beneficiary in instalments. The track record of the projects associated with the Institutional Housing Programme affords the opportunity to consider how risks associated with early subsidy of deferred ownership options have been managed in South Africa and derive lessons from this experience.

The private sector has also developed and run deferred ownership schemes. In the recent past, bigger schemes were largely run as employer housing schemes. More recently, the private sector has sought to finance these schemes with private employer subsidies. The newer schemes have only financed households with incomes higher than those in the FLISP market. Lessons for early subsidisation can be drawn from the experience of these companies too.

The purpose of this paper is to weigh up the advantages that may arise from early subsidisation of deferred ownership and the associated risks, especially for households in the gap market that cannot access mortgages. We will consider whether such risks can be practically managed through careful design of the funding and institutional arrangements. The key question to consider is whether, and if so, how such schemes can be subsidised in their earlier development stage in ways that avoid or manage the risks outlined above. The report will, in future, ultimately lead to the design of guidelines for early subsidisation of deferred ownership schemes, if such subsidisation proves feasible.

The **second chapter** of the paper develops a ***conceptual framework*** to understand key deferred ownership instruments used in housing markets and unpacks the design parameters and risk issues that need to be considered and managed when designing funding and institutional arrangements. The chapter concludes with laying out a normative framework for assessing how well the institutional arrangements related to deferred ownership address related risks.

The content of the chapter is drawn together from only a partial literature review of the topic of deferred ownership. Globally, very little research work has been undertaken on deferred ownership initiatives[3]. Most of the literature on deferred ownership is from the United States, and accessing it was at first hamstrung by ignorance about key search words. A few texts have been found, but it would appear there is more relevant literature to explore. A significant portion of the content was also drawn from discussions with role players in the South African context.

In **Chapter 3**, we outline briefly how the use of such instruments are catered for in South Africa's regulatory framework. The ***regulatory framework*** forms a key part of the institutional framework, and thus a key aspect of managing risk. Parts of the regulatory framework have been specifically set up to protect consumers. In this section, we largely confine ourselves to outlining this framework. The regulatory framework, which applies to the lease option arrangement, is not covered in this report. Given that there are no specific measures covering it, explaining it requires specialist legal knowledge. We propose that it be addressed in the research process recommended. Much of the framework was put in place recently and is generally considered adequate. This section is largely purely descriptive and only a cursory evaluation of the framework is attempted.

[3] Marja Hoek-Smit, Director, International Housing Finance Program/Real Estate Center, The Wharton School, University of Pennsylvania, personal communication, October 2019.

The chapter largely provides a description of the main features of the legislation designed to protect buyers in instalment sales – the Alienation of Land Act 68 of 1981. The description is drawn predominantly from a commentary on the Act given in LAWSA. We also received input from attorneys working in the property field and from key staff in private sector sellers on certain matters. The other pieces of relevant consumer protection legislation were identified through discussion with sellers and by internet-based research. We consulted several online commentaries. The original legislation was also examined in a number of cases.

In **Chapter 4**, the report looks at how deferred ownership approaches have been or are currently being deployed in South Africa in both government and private settings to provide affordable housing for ownership. The report does not examine privately funded lease option arrangements. Using a ***case study*** approach, we consider how schemes and initiatives have been set up and begin to consider whether the key risks are adequately addressed and how.

All Institutional Housing projects implemented in the Western Cape from the time of its advent were studied to some degree. The main source of information was a set of interviews with a single source from the seller involved in the project. Interview information was sometimes supplemented by supporting documents and materials provided by the source person or found on the internet. Sometimes press reports were used. The most extensive research was undertaken for the Cape Town Community Housing Company (CTCHC) case study, where former officials and a current official of the CTCHC were consulted, and a range of documentary information was provided. The Housing Association of Blaauwberg (HAB) case study, given the historical nature of the project, is based on very fragmentary information, mainly drawn from press reports. Some additional information, mainly on the current status of the project, was provided by a former official of the City of Cape Town. The case studies of privately funded initiatives were drawn from interviews with a single key individual from each of the companies studied. Supporting information, such as a sample contract, was not made available as it was deemed proprietary by the companies. Draft write-ups were shared with respondents to check accuracy and the write-ups were redrafted to take into account comments and address issues highlighted. Key omissions in the research include the examination of audited financial reports of the institutions and a more thorough examination of financial performance.

Chapter 5 draws out ***findings and lessons*** from the case studies considered in Chapter 4 and begins to suggest how the viable subsidy programme can be designed. We will consider whether the private sector can provide affordable units and whether current subsidy levels are sustainable.

In the concluding chapter, Chapter 6, we address each of the research questions posed here based on the understanding gleaned through the research process, and the evidence collected from the cases studied. We also lay out what the responses to the research questions suggest about the development of a framework for early subsidisation of deferred ownership. Our suggestions are formulated as recommendations for policy and further policy research.

In conclusion, in **Chapter 6**, we reflect on what our research on risks, regulations and the South African experience suggests about ***how the research questions can be answered***. Given the rapid and partial nature of the research conducted, these answers should be seen as tentative and contingent. We highlight ***emerging rules or principles*** which, in our opinion, should be used in the construction of a policy framework for the early subsidisation of deferred ownership models. Topics and questions that require more detailed work will also be identified.

2 CONCEPTUAL FRAMEWORK

In this chapter, we develop a conceptual framework to understand key deferred ownership instruments used in housing markets and unpack the design parameters and risk issues that need to be considered and managed when designing the funding and institutional arrangements. The chapter concludes with laying out a normative framework for assessing how well the institutional arrangements related to deferred ownership address the related risks. This chapter is largely summative and drawn from discussions with practitioners and from on-line explanations and comments on South African regulation and materials from current initiatives. A few US texts proved useful in understanding the regulatory debates and to develop the terminology used in this report. Attributing ideas and concepts in this chapter is thus difficult; we do this where attribution is clear.

The chapter starts with defining the two basic types of deferred ownership[4] arrangements considered in this report: lease option and instalment sale.

Lease option

Lease option is sometimes referred to as rent with an option to buy. The prospective owner (the buyer) enters into an agreement with the current owner of the property (the seller) to rent the property for a period, having the option to buy the property at a pre-determined price after that period has lapsed[5]. For instance, in the case of the Institutional Subsidy (discussed in Chapter 4), the buyer/beneficiary rents the property for four years from the housing institution before being given the option to buy the property at a price set at the beginning of the agreement. In this case, the price is roughly equal to the cost of building minus the Institutional Subsidy. The arrangement is structured as two separate agreements: a rental agreement and an option agreement. The option agreement includes an offer to purchase agreement that is conditional upon the aspirant buyer acquiring finance to purchase the unit (i.e. suspensive).

For the buyer, the rationale of such schemes is that they allow the buyer a defined period in which they can get their finances "in order" to buy the house at a certain locked-in future sales price, including acquiring a credit record or rectifying it, while also getting the benefit of the use of the property[6].

For sellers, the arrangement could facilitate sales in markets in which mortgages are somewhat difficult to obtain due to affordability constraints (often related to indebtedness); sellers may seek

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[4] Popularly used terminology for these schemes tends to be confusing, with the same terms being used to refer to the two different types of schemes. Rent to buy and rent to own are often used to refer to rent with an option to buy but can also be used to refer to instalment sales or as a "catch-all" term for deferred ownership schemes. There are also instances where instalment sales refer to lease option sales where the rent includes a savings portion used to raise the required deposit for mortgage when the option to buy is taken up by the lessee.

[5] Lease purchase is the arrangement in which the buyer is legally required to purchase the property at a pre-set price and can be sued, even if the they cannot raise finance to make the purchase. This variation is not widely used in South Africa.

[6] Folger, J. 20 November 2019. Rent-to-own homes: How the process works. Investopedia. https://www.investopedia.com/updates/rent-to-own-homes/

such markets if other property markets are sluggish, etc. In addition, such arrangements may help manage downside capital risks associated with declining property prices.

In most schemes, the buyer pays an option fee at the beginning of a period, which is forfeited if the option to buy is not taken up[7]. The option fee is usually a defined percentage of the sales price. Option fees cover in some way the opportunity costs for the seller of fixing the selling price for a future sale and forgoing capital gains in the intervening period. Presumably the option fee is set at a level less than the probable capital gains, so as not to undermine the rationale of the scheme for the buyer. Options may be "optional" or mandatory[8]. Sometimes the option fee is used as some kind of capital payment for the post-lease loan to finance the sale of the unit to the buyer.[9]

Upfront payments (often called "deposits") besides the option fee usually include a standard rental deposit, refundable if there is no damage or breakages, etc.

The obligation to maintain the property and pay property taxes and other service charges is also subject to the agreement and aspirant buyers may be assigned these responsibilities, although the legal responsibility to pay property rates lies with the owner/seller and not the aspirant buyer. The seller sometimes assigns the responsibility for the collection of rates and maintenance to management agencies, which charge a service fee.

In some arrangements, monthly rental payments include a savings portion used to raise the deposit for the housing loan upon sale. Such schemes raise the monthly payment required of aspirant buyers.

Given that a key part of the rationale of the lease option arrangement is to provide time to prospective buyers to prepare their finances for property purchase, which includes meeting credit profile requirements, some schemes include the mandatory provision of "financial coaching services". Service charges are usually included in the monthly rental to cover the cost of these services[10].

In a lease option arrangement, the seller enjoys real rights in comparison to the lessee's (and aspirant buyer's) personal rights and thus, without regulation, a lessee may be disadvantaged. For instance, a lessee may not be granted the opportunity to purchase the unit at the end of the lease period despite paying the option fee, or additional conditions may be applied by the seller at the end of the period to take up the option to buy. It would seem that the lease options tend not to be governed by specific bespoke regulation but rather through general consumer protection legislation and through rental legislation. This is a specialised area of investigation which has not been undertaken in this report.

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[7] This is not the case for the Institutional Subsidy. The housing institution charges no option fee (see Chapter 4).

[8] A lease purchase arrangement has a mandatory option.

[9] This may be the case if the owner of the unit becomes the seller in an instalment sales agreement where the lessee is the buyer and is likely to be subject to certain conditions, e.g. added to buyer's capital only at the end of the loan period if the buyer sees out the entire term (Rent to Buy option agreement between Sentinel and the Purchaser. 2020. Meyer de Waal: Cape Town.).

[10] Bechard, M. 21 December 2018. *Rent2Buy: A new way to owning a home.* IOL. https://www.iol.co.za/personal-finance/investments/rent2buy-a-new-way-to-owning-a-home-18478317

Instalment sales

The buyer enters into an agreement with the seller (who is usually, but not necessarily, the owner of the property[11]) to buy the unit in instalments over a defined period, the maturity period of the loan agreement. During the period in which the instalment payments are made, the buyer takes occupation of the property and can enjoy all the rights of use of the property, while the owner retains legal title as security until the buyer pays in full[12]. In the US context, the buyer is said to have "equitable ownership" of the property[13]. The rights associated with this so-called equitable ownership seem to depend on the agreement between the buyer and seller. A key issue is protection of the buyer's investment in the property over the course of the instalment sale, given that the property is still owned by the seller and may be encumbered by a lien or become part of an insolvent/sequestrated or deceased estate. The buyer's equitable ownership of the property would include some protection against claims made by creditors of the seller. **Abuses of buyers by instalment sellers have, in most jurisdictions, led to the regulation of these arrangements to protect consumers, i.e. buyers.**

The instalment sales agreement remains central to managing the payment arrangement, safeguarding rights and assigning responsibilities associated with property ownership, including maintenance and payment of property taxes and levies. Agreements are thus one of the key objects of regulations. For instance, regulation usually requires that an instalment sales agreement, like a normal sales agreement, is reduced to writing.

An instalment sale is often characterised as a **seller-financed extended loan to the buyer**. Instalments over the defined period will be set to include a capital and interest component. The instalment sale[14] is usually thought of as having a lower cost and being more flexible than a mortgage-funded outright sale. These characteristics arise because the buyer does not have to go through a mortgage provider's application process and meet its requirements and various relatively costly registration processes and administration fees associated with transfer can be forgone, i.e. mortgage and property registration[15]. If the agreement is terminated, similar costly de-registration processes can be avoided. "Parties can quietly unwind the transaction by recording a termination of instalment agreement – no foreclosures or deed in lieu of foreclosure is needed[16]." However, in some instances, sellers may recover the costs of purchasing existing units for on-selling via instalment sales, charging a significant mark-up fee.

An instalment sales agreement shares some of the characteristics with a mortgage loan-financed outright sale. Instalment loans often have similar loan repayment structures to mortgages, i.e. the loan is repaid through fixed monthly instalments with a capital and an interest component over a long period. The loan repayment is amortised: in each instalment, the capital redeemed in the loan is residual of the interest charged on the capital owing, which means that the capital component grows slowly over time, while the interest component shrinks. Buyers also get user rights of the

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[11] This paper generally considers only the situation in which the seller is the owner of the property.

[12] Weintraub, E. 22 August 2019. How a Land Contract Works for Buying Homes. Why Home Buyers Like Land Contracts. The Balance. https://www.thebalance.com/how-a-land-contract-works-1798432

[13] Pregmon, P. 2015. Instalment Agreement. Conservation Tools.org, Pennsylvania Land Trust Association. https://conservationtools.org/guides/26-instalment-agreement

[14] A number of alternative terms are contained in the literature: instalment agreement, land contract, instalment sale contracts, contracts for deeds, contract for deed transactions, deed of sale agreement.

[15] Paul McHardy, Executive Manager, Chartwell Housing Finance Solutions, personal communication, May 2019.

[16] Pregmon, 2015.

property during the loan period as in the mortgage. The two transactions differ in that in a mortgage-financed sale the buyer owns the property outright over the loan period, whereas in the instalment sale, the seller owns the property over the loan period. **This difference may give the seller important advantages in his/her ability to manage buyer non-payment risks and could open the way for banks to advance mortgage finance into markets they have viewed as traditionally too risky.** In a mortgage-financed loan, the loan provider would have to foreclose on the property, which is a costly, time-consuming process in which the bank may suffer losses, and which is subject to political risk. In an instalment sale, the seller can theoretically merely cancel the instalment sales agreement (ISA), and the bank financing the seller via a mortgage loan to purchase the property to on-sell via instalments will not face the risks associated with foreclosure. As mentioned in the paragraph above, there may also be differences in the two types of transactions in the way that property related transaction costs are paid for by the buyer.

2.1 Key risks and constraints

The report is particularly concerned with the risks that open up for government due to the provision of subsidies relatively early in the creation of ownership opportunities for sale via deferred ownership mechanisms. Because ownership is deferred, there is an intervening period between the agreement and property transfer in which circumstances can arise which could jeopardise the final transfer of the property. Beneficiaries may not make their required financial contributions in full (either wilfully or because of affordability problems arising from external factors), undermining the financing and sustainability of such schemes in the intervening period. Second, the sellers may not be able to sustain the schemes because of inadequate capacity and financial resources or poor management, leading to a collapse of the scheme before final transfer of ownership. Third, sellers may develop poor quality products and if subsidy beneficiaries are locked into a particular project, beneficiaries may have little choice to avoid the poor-quality products, which could lead to non-payment and withdrawal of contributions. Subsidies may also leak from original beneficiaries to others in the same target market, or more worryingly, to households in higher-income markets as sellers seek replacement buyers. Furthermore, if the schemes are government funded and/or run, keeping the schemes going as deferred ownership schemes may prove too onerous. The government may simply run them as rental schemes in which budget shortfalls arising from a lack of adequate rent collection are filled partially on an ad hoc basis to avert complete collapse.

To understand the risks giving rise to these impacts, we discuss the main risks for each type of deferred ownership sale without the involvement of government. We then consider the risks that arise from government involvement.

2.1.1 Lease option

This report focusses on the risks related to the lease part of the agreement, up to and including the buyer taking up the option from the seller or the buyer refusing to take up the option and exiting the agreement. The purchase part of the agreement, financed through a mortgage or other means, is beyond the scope of this report.[17]

2.1.1.1 Buyer risks[18]

- Buyers face capital risks if there is a downturn in the property market during the leasing period, in that they are locked to the price set in the option and stand to lose their option fee and the ancillary costs of participating in the scheme, should they fail to take up the option. If the rents charged are above market rates, the lessee may feel under more pressure take up the option when the lease period is over. A declining market would put the buyer at a disadvantage, if the future price was set when the market was high.
- Buyers may also face the risk of losing their option fee if they are unable to keep up rental payments following a loss of income due to job loss or some other catastrophic event and leave

[17] The aspirant buyer can finance taking up the option in several ways. For instance, it can be financed through an instalment sale. Risks associated with instalments sales would be relevant. An instalment sale, however, further defers ownership and may be difficult for sellers to justify. Although not examined in this report, there is a lease option brokered by Meyer de Waal (a lease option agency operating in South Africa) in which the option can be financed through an instalment sale.

[18] Edelman, S., Zonta, M., and Gordon, J. 29 April 2015. Lease Purchase Failed Before – Can It Work Now? Center for American Progress. https://www.americanprogress.org/issues/economy/reports/2015/04/29/112014/lease-purchase-failed-before-can-it-work-now/

the scheme, or the buyers credit worthiness or credit record fails to improve sufficiently during the rental period.

- Buyers may not be able to detect latent defects and quality issues prior to the agreement, which may only surface within the rental period and thus also face the risk of being overcharged.
- Buyers may face the risk of abuse from sellers who do not honour the agreement or face onerous or disadvantageous terms and conditions written into the small print of the contract that are difficult for buyers to discern.
- Depending on how schemes structure buyer payments, buyers may be subjected to a payment shock as they move from the rental to the loan repayment stage, especially if schemes hold rents artificially low to attract customers and may ultimately lose access to the property.
- Given that lease option mechanisms are complicated, including as they do, present and future stages of renting and purchase with a range of fees and responsibilities, buyers are susceptible to misunderstanding the mechanism and what they are getting into.
- Buyers may face maintenance responsibilities (and associated financial costs) that are not in line with the tenure and rights they enjoy on the property and face losses if they do not take up the option to buy.
- If the units are not registerable when the option to buy falls due at the end of the lease period, buyers may be deprived of full ownership for at least a period and be forced to pay occupational rent rather than make capital payments.

2.1.1.2 Seller risks

- Prospective buyers fail to pay rent and may have to be evicted. This becomes a risk if the regulatory environment makes eviction difficult. Delayed evictions undermine cost recovery and freeze opportunities for ownership in such schemes. Sellers may face other regulatory risks, related to the way courts see this form of tenure. Courts may view lease option agreements as granting lessees more rights than a standard lease agreement and may thus be more reluctant to grant eviction where related lease agreements are breached[19].
- Aspirant buyers fail to take up the option to purchase and then remain in the unit.
- Sellers face capital risks in a rising market.
- Seller risks are confined to the lease period before outright sale; outright sale shifts the risk to the loan provider. The non-payment risk in the lease period may be substantially higher than non-payment in an instalment sale if a "dignified exit" mechanism exists for instalment sales.
- Buyers lacking experience of or historical exposure to housing markets may be unable to distinguish the lease phase from the buying and loan repayment stage and may withdraw co-operation upon realising that rental payments are not contributing towards capital repayments[20].

2.1.2 Instalment sales

The report covers risk during the instalment sales period and excludes risk should an outright sale occur.

[19] Heather Maxwell, CEO, Social Housing Company (SOHCO) Group, personal communication, September 2019; Renier Erasmus, CEO of Madulammoho Housing Association, personal communication, 11 September 2019.

[20] Renier Erasmus, personal communication, September 2019.

2.1.2.1 Buyer risks[21]

- Instalment buyers face greater building quality risks (and associated price overcharge risks) than outright mortgage-financed buyers, as mortgage providers will only provide loans for properties valued at or below the loan value.
- Buyers face the risk of losing their capital instalment for the purchase of property, as they only hold equitable ownership rights or personal rights, as opposed to the real rights that arise from full ownership, held by the owner/seller. If the property is encumbered (used as security in loans taken up the owner), insolvency, default or death may trigger claims on the property by creditors. The buyer's claim of the capital contributions they have made (and the forgone interest earned) beyond rent may receive a lower order than other claims in law or by the courts[22].
- Given that the instalment sales process can be delinked from the property subdivision or sectioning process, as the property is still owned by the seller during the instalment sales process, the buyer faces the risk that the property will not be transferable when the instalment sales agreement is completed. This would be extremely disadvantageous to the buyer.
- Capital losses may also arise if sellers fail to meet financial obligations by paying off existing mortgages or liens or fail to make transfer at the end of the maturity period when the buyer has fully paid off the loan. Sellers may encumber the property to such an extent that transfer into outright ownership is effectively thwarted and the seller continues to enjoy the benefits of property ownership, despite the buyers having met the obligations of the agreement.
- Capital loss risks for the buyer, in which the buyer loses their capital contribution, may also arise from income loss or spending shocks which result in a loss of the ability to pay instalments.
- There is also a risk that the buyer may be squeezed out of schemes by payment structures that become unaffordable over time. For instance, if instalments are set to increase at rates above inflation or above wage increases, they are likely to squeeze buyers, especially those in the lower-gap market, where household budgets are likely be very tight. Longer maturity periods may lower and smooth out instalments, but then require a longer-term presence of the owner/developer in the development. (Instalments that mimic mortgage payment, i.e. that are essentially static in nominal terms and have maturity periods similar to those of mortgages, are less risky for buyers).
- Restrictive payment regimes may prevent buyers from reducing payment periods through pre-payment. Pre-payment reduces the total interest paid and expedites full transfer.
- Sectional title schemes and their buyers are subject to the standard risks associated with the such schemes – susceptibility to negative feedback loops between levy non-payment and decline in maintenance which increases non-payment. Body corporate members may be reluctant to act against their neighbours, putting the non-payment cycle in motion. Acting early to recover arrears may also be difficult, as the only asset the body corporate has to attach may

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[21] Largely drawn from Mancini, S. and Saunders, M. 13 April 2017. *Land Instalment Contracts: The Newest Wave of Predatory Home Lending Threatening Communities of Color.* National Consumer Law Center. https://www.bostonfed.org/publications/communities-and-banking/2017/spring/land-installment-contracts-newest-wave-of-predatory-home-lending-threatening-communities-of-color.aspx

[22] Marja Hoek-Smit, Director, International Housing Finance Program/Real Estate Center, The Wharton School, University of Pennsylvania, personal communication, October 2019.

be the fixed property. Arrears need to accumulate to large levels in order to justify such action and by that time it may be too late to the save the scheme[23].

2.1.2.2 Seller risks and constraints

- The buyer non-payment risks in instalment sales are similar to those in lease option schemes. Where the regulatory framework protects against eviction, non-payment risks are heightened and need to be carefully managed. The equitable ownership status of buyers could help sellers to mitigate the non-payment risk by offering buyers a relatively "dignified exit" (see 2.3 (2) below) from the schemes in which the buyer could retain any capital gains[24].
- Instalment sales operations are inherently unstable for sellers, in that over time, as groups of buyers achieve full ownership, the administrative requirements of a scheme decline over time eroding scale economies and increasing overhead costs. This problem is exacerbated by long loan maturity periods, as the withdrawal period is extended over time, meaning that the strain is extended over a longer period. With shorter maturity periods, full ownership is likely to be achieved over a much more confined period (clustered right at the end of the period), and the business can be shut down at the same time that scale economies are lost.
- The latter dynamic, set in motion by extended maturities, requires that instalment sellers broaden and grow their businesses over time, to ensure the scale economies are sustained over time and that overheads remain efficiently used and costs are kept competitive[25]. A sustained period of engagement in the business requires a diversity of development funding sources[26].
- In freehold schemes, the common spaces are essentially public spaces and the responsibility of municipalities. However, the lack of maintenance of these public spaces may be perceived to be an omission by the seller and lead to reduced instalment payments from buyers.
- Sectional title schemes have risks for sellers who still own properties within the sectional title scheme very similar to the risks for buyers. Declines in maintenance in a scheme can also have a negative impact on instalment sales payments.

[23] Renier Erasmus, personal communication, September 2017.
[24] Paul McHardy, personal communication, May 2019.
[25] Renier Erasmus, personal communication, September 2019.
[26] Marja Hoek-Smit, personal communication, October 2019.

2.2 Early subsidies and/or government supply

The provision of early government subsidies in the development process increases a number of these risks dramatically. As mentioned in Chapter 1, government subsidisation can occur in two broad models:

- **Direct supply model:** The government develops the units using its own financial resources and becomes the seller, either renting out the unit before selling it to the beneficiary outright, if the rental period proves successful, or selling it in instalments to the beneficiary from the outset. The sales price is the cost of unit discounted by the relevant subsidy amount. The cost of unit may be further reduced by hidden subsidies that arise from a government-financed construction process using housing grant monies, e.g. limited development finance costs, no holding costs, etc. If the capital is grant funded, government may be able to provide the loans to the buyer at zero interest.
- **Arm's-length model:** The government provides subsidies to third-party developers which are separate from government and could take the form of profit or non-profit companies or organisations.

There are essentially two broad risks or negative impacts that arise from early subsidisation. First, the subsidy provided, or more correctly, the benefit of the subsidy, leaks to another person. The leakage is more severe if the other person is outside of the beneficiary target group, for instance, earns a higher income than targeted. Second, the subsidy may not lead to the provision of the intended benefit and may result in a lower-grade benefit and/or a benefit that continues to incur cost for the government, tying up resources that could have been used for the supply of additional benefits. These two risks are also interconnected.

- Beneficiaries/buyers face a particularly strong product quality risk arising from the early flow of subsidisation, as the subsidy approval process is often seen to overshadow beneficiary choice. Consumer choice is logistically higher circumscribed if the approval of subsidy predates the construction process. It is very difficult for a beneficiary to withdraw themselves from a project if they are unhappy with the product built, as they would forfeit an opportunity that they may never receive again. Certainly, the receipt of a product that is more preferred is difficult for the beneficiary to predict accurately.
- Given that all deferred ownership schemes rest on buyer/beneficiary contributions, non-payment by the beneficiary will undermine the schemes and could lead to the type of leakage described above, as sellers seek to replace non-paying beneficiaries and ownership units become long-term rental units or essentially free units without proper tenure. Given that subsidy housing tends to be politicised, association with the government as an owner/developer or subsidy provider, may increase the risk of non-payment. Government may interfere with cost recovery and undermine revenue collection to placate vocal groups with political backing or avoid social protest.
- Mismanagement by the seller may also lead to leakage on the capital and operational side, as the scheme may fail to materialise in full. Given that the focus of subsidy programmes is on poor households, there is pressure to recruit beneficiary buyers without taking into account their ability to pay. Such a focus may also derogate from cost recovery and lead to inadequate billing and contract enforcement. Furthermore, rents and instalment payment structures may not be designed for market affordability, as this is seen as secondary.
- Sellers may feel that the stakes of enforcing conditions in an aggressive manner for government are too high and could expect a softening of terms over time. For instance, government may

allow sellers' beneficiary target groups to drift upward, so that they can meet operation financing targets and sustain the schemes, rather than see schemes fold or have to find replacement sellers. Where the subsidies are income-based, such an allowance would result in leakage.

- If subsidies are involved in the creation of units, subsidies would also be lost (along with contributions of buyers), should sellers go insolvent and their debts are secured via the property, if there is a downturn in the property market resulting in a loss of market value.

In comparison with early subsidisation, the provision of **subsidies later in the process, i.e. at a point in the process in which the provision of the subsidy concludes the deferred ownership period and results in outright ownership** (and property transfer) for the buyer, introduces far less risk for government. The decline in risk results because at the point of subsidy, the product is complete and quality and "registrability" problems are more manifest to all parties. The risks that result in this situation would be very like the risks associated with the provision of the FLISP as a mortgage deposit subsidy, **where a mortgage is provided to finance the outright sale or the transfer of a free subsidy house, where no further loan is required.** Essentially, in this arrangement, the subsidisation occurs after the rental or instalment payment period, the riskiest stages in the process for the buyer, as ownership rights for the buyer are not real. Once owned by the beneficiary, there are the leakage risks related to the beneficiary selling or being forced to sell or having the property foreclosed by the mortgage lender. It seems that government is moving away from a pre-emptive clause (a period in which formal sale is restricted) as a control measure where mortgage subsidies are provided in the belief that, as the beneficiary is contributing to the purchase of the property, his/her interest is likely to coincide with the government's, i.e. that the property will be used as an asset by the beneficiary over a prolonged period. Such co-incidence, in turn, rests on the assumption that the property is gaining value over time and not losing it.

2.3 Normative framework for managing risks

As discussed in section 2.1.1 of this chapter, the risks for the buyer in a deferred ownership arrangement arise from the buyer having personal rights while the seller has real rights during the arrangement[27]. This contrasts with an outright sale through a mortgage, where the buyer enjoys real rights to the property being bought. There are also more standard buyer risks that originate from this as it is a debt arrangement and involves the sale and transfer of fixed property. In addition, there are risks that arise from the form of tenure, especially tenure where there are privately owned, shared spaces surrounding the property which contribute significantly to the value of the property. The lease option arrangement may be considerably risky for aspirant buyers, especially during the leasing stage. We refer to these issues as "red flag" issues in this report and examine them in Box 1 below.

For the seller, risk may arise when the real rights the seller enjoys are disrupted or compromised. Other risks arise from the nature of the business and through political interference, especially where public resources, such as subsidies, government concessionary finance and land and infrastructure are involved.

Risks may arise when there is an asymmetry of information between the parties, the parties have differential security over the asset (especially where one party has weak security of the asset) and when use of the asset is limited.

The risk management framework may be promoted through at least three sets of institutional relationships or sites of interaction:

- at the legislative or regulatory level
- at the project level, between seller and buyer and financier
- at the point of the provision of subsidies, and the subsidy rules and application of these rules.

Objectives for managing buyer risks

1. Holding some kind of security over the property purchased

In a deferred ownership situation, the seller can encumber the property by using it as security for a loan (including a mortgage to buy the property itself) or the property may be attached as a part of a sale in execution. These actions and situations lower the security the buyer has over the property as he or she is paying it off or leasing in preparation of purchase. Measures should be put in place to limit the extent to which the property is encumbered and protect the buyer where the seller is insolvent.

Sellers should be prevented from acting with malfeasance, such as selling the property to multiple buyers.

[27] Section 2.3 of this chapter is drawn in large part from Edelman, Zonta and Gordan, 2015 and Mancini and Saunders, 2017.

2. Retaining capital stakes and benefiting from capital gains should the buyer withdraw from the sale

Buyers should be able to retain their capital contributions and any gain in the value of the property (while sellers are compensated for costs associated with the build-up of arrears, the maintenance and upgrade during the deferred ownership arrangement). Rights should be written into law and into contracts between seller and buyer. The ability of the buyer to retain capital contributions and gains is also critical to the creation of an exit mechanism for the buyer that can be referred to as "dignified". Such a mechanism could lead to the avoidance of non-payment problems for sellers.

3. Assured quality of the property purchased

As is the case in any normal fixed property sale, the seller may know more about the property than the buyer and may not disclose faults. Furthermore, fixed property is a relatively expensive and complicated product and buyers may not be able to assess the value of the product, and so, can make poor buying decisions. Buyers can be given technical support in deciding to buy, and sellers should be sanctioned if found to be deliberately misleading. The situation is riskier if the deferred sales arrangement precedes the building of the development, as the buyer is committing to the debt, and sometimes, even paying down the capital, before being able to see and assess the quality of the product. Consumer protection measures are required, including warranties and insurance schemes, the independent assessment of quality and cooling-off periods.

4. Taking on responsible debt to purchase the property

Consumer risks associated with taking on debt are relatively well known. Sellers or financiers may take on clients who cannot afford to service the debt or show poor credit histories in exchange for relatively short-term gains in the form of upfront fees or high interest rates. Credit providers are required to check debtors' ability to pay (i.e. affordability) and inform debtors about how the loan works, the consequences of non-payment and how they can best meet their obligations. Therefore, reckless credit agreements with buyers include those where: (i) the credit provider has not assessed the buyer's ability to pay the agreed upon amount, (ii) entering into the agreement makes the buyer over-indebted or (iii) the buyer does not understand their obligations, risks and costs. These reckless credit agreements should be avoided. The propensity to pay is also sometimes considered, i.e. the buyer's debt re-payment history under other credit agreements should also be considered. Buyers (i.e. debtors) also need to be given a chance to remedy non-payment and arrears and be provided with information on the precise nature of the arrears and options to remedy the situation. Fines for non-payment also need to be kept to a fair level, providing adequate cost recovery, but not so punitive as to drive the situation beyond the point of no return too quickly. If consumer insurance against buyer income shocks is required of the buyer, the insurance fees should be included in the affordability assessment required by credit consumer protection law.

In an instalment sale, the credit provider can probably best meet affordability requirements by structuring the loan payment terms in a similar way to a mortgage, with similar maturity periods, interest rates and payment structures. This should also include the conditions under which the buyer can a) shorten the period by increasing the instalments and the how the interest is to be calculated in that instance or b) pay the remaining portion as a lump sum, which may or may not be financed through a loan or mortgage, and the procedures to be followed in the case of a) and b).

5. Buying and gaining successful transfer of the property

The normal process of buying and gaining transfer of property is complicated and subject to risk. Tolerance for mistakes is quite low. The property being transacted needs to be precisely identified and known to all parties and to the world, and the transaction publicly recorded to prove new ownership. Usage rights are also linked to the property and any upgrading of these rights during the development or sales of property makes the sales and transfers more complicated and riskier. Transfers with changes in land-use are subject to authorisation which often requires consultation with a wide variety of stakeholders. Any aspect of this process, where the outcome is uncertain, should be completed before a deferred ownership arrangement is set up; the buyer needs to be protected to ensure transfer occurs. In other words, property should be "registrable" before deferred ownership sales arrangements are concluded.

Box 1: Discussion of the relatively high risk of lease option ("Red flag" issues) and some specific principles to limit buyer risk

The lease option arrangement may pose a considerable risk for aspirant buyers, especially during the leasing stage. We refer to these concerns as "red flag" issues in this report. During the leasing stage, the aspirant buyer has limited rights over the property: the seller is definitely the landlord, and the aspirant buyer has no real capital stake in the property. The seller may be able to encumber the property before the option to purchase arises or even transfer the property to another buyer.

The following characteristics contribute to the risk faced by aspirant buyers:

Costs to participate in the scheme and gain the option to purchase may be high because of:

- including rents higher than market value (i.e. premium rents)
- assuming of all maintenance costs
- property tax liabilities for aspirant buyers.

Cost premiums above the market norms for medium-/long-term rental should be kept to a minimum.

The option fee essentially becomes part of the sales price.

A high option fee would limit any gains the buyer can make and removes the rationale for the lease option arrangement. A key risk is an unforeseen downturn in the property market during the lease period.

Aspirant buyers need to obtain affordable finance at the option stage.

The risk arises from not being able to recover the credit record and/or obtain finance to take up the option to purchase at the end of the period because the buyer is unable to obtain reasonably priced finance.

Lack of recourse if the developer reneges on agreement and cannot provide the option.

Losses include the option fee, premiums to participate and the opportunity to acquire the property.

Objectives for managing seller risks

The risks to the seller and the regulations that protect them will not be discussed in detail. However, the following are some of the principles to be considered in the case of the seller's risks in deferred ownership:

1. Enforcing payment within a balanced eviction regime

For property sales, the ultimate sanction for non-payment is the ability of the credit provider, which in the case of instalment sales is the seller, to evict the buyer and gain "vacant access" of the property. The property ownership regime, including how the courts enforce the rights of each party, should be set to achieve the correct balance between owners and buyers. The creation of perverse incentives should be included in the calculus, i.e. if eviction is too difficult for the seller to affect, the buyer will not pay or pay only in part and build up arrears.

2. Avoiding political interference

Deferred ownership developments that are government subsidised or fall on government land are often susceptible to political interference or lack of political support for their developers. This susceptibility arises from their spatial concentration and the contribution required of beneficiaries where beneficiaries do not own outright (not an orthodox property arrangement). This situation lends itself to politicians promising to reduce beneficiary contributions in exchange for support and encouraging payment boycotts or rewarding evictees by providing them with other subsidised opportunities.

3. Retaining the value of capital before transfer

The seller's property, where subject to deferred ownership arrangements, is at risk of losing capital value in a number of ways. For example, if the buyer causes damage to the property and then exits the agreement, the seller may not be able to realise the "full" value of the property in selling to a new buyer or would have to cover the additional costs of repairs. Poor site location and a downturn in the property market can also result in lower than expected or predicted capital gains (although these risks are beyond the scope of this report).

4. Creating legal certainty and building the competence of the court

Because the regulatory instruments are not widely used, the courts and legal community may not understand them fully. This is likely to be a bigger problem in the more affordable, lower courts in particular. Complicated legal provisions are required to take account of the unorthodox distribution of rights between buyers and sellers, and the need to protect buyers without jeopardising sellers, but these are not easy to understand and can be written in particularly inaccessible language. There also appears to be a lack of clarity on the legislation around lease option deals.

The legal profession and government could provide materials on the legislative framework, while the universities can give support to the sector by increasing training and research, e.g. the unit partially set up by the University of Cape Town to provide support to a range of sectional title role players (Paddocks[28]).

[28] https://www.paddocks.co.za/

5. Clarifying property tax liability

Property tax can add to the overall cost and administrative burden of the collection of payments by the seller. Enforcing collection could increase the buyer's costs to the point that they choose non-payment. However, if property taxes such as rates are supposed to be paid directly by the buyer to the municipality and are not, these arrears could jeopardise transfer of the property from the seller to a third party in the event of the buyer or seller wanting to exit the agreement. Therefore, administering the collection of these types of taxes affords developers/sellers better control.

Depending on the tax arrangements related to the property, the tax of a seller may also prevent the transfer to full ownership for the buyer from occurring. This could occur especially in a lease option arrangement, where ownership is more definitely held by the seller. Buyers should understand the tax liabilities of the seller, be able to check up on them and have recourse if transfer is placed in jeopardy.

6. Having clear and stable rules for subsidised developers

Sellers and buyers may face risks from participating in schemes established and run by weak developers. Weaknesses may arise because government, especially municipalities, allow the waiving of the standard procedures related to development control and township establishment. DFIs providing concessionary finance may not be as rigorous in overseeing developers financially. Government bodies should refrain from providing waivers or soft peddling on subsidised developers. Developers should be completely separate from the government/municipal authorities where institutional housing schemes are being built.

7. Retaining the ability to select buyers

The selection of buyers should be based on affordability and particularly the buyer's propensity to pay. Selection of buyers could particularly be a problem for subsidy schemes, as eligible buyers would have to comply with certain eligibility criteria and be drawn from waiting lists. This could potentially limit the seller's choice of buyers if not managed correctly. However, the discretion of the seller to select buyers should be maintained and could be promoted within the subsidy rules if necessary.

8. Ensuring economies of scale and diversity of funding

Because deferred ownership providers, especially those providing instalment sales, have long-term relationships with buyers and the interest earnings from each buyer decline over time, providers have to continually expand (build economies of scale) to keep overheads low and diversify their funding sources. The necessity to expand could require entry into riskier markets. Providers need to be conscious of these dynamics and address them head-on. Innovations in information technology could help to lower overhead costs, especially in driving down transaction costs in the buying of property and reselling through instalment sales arrangements.

9. Preserving value in medium- to high-density private developments with shared areas/ facilities

In medium-/high-density private developments, both privately and jointly owned, there is a risk that shared facilities will not be adequately maintained as the financing will break down due to negative spiral affects. Substantial value of the individual unit may be lost if the shared areas deteriorate and the development becomes a slum. In South Africa, the most common form of tenure in developments with shared facilities is sectional title with governance structures called body corporates. Buyers should be educated about these structures and the affordability assessments must include the costs of running body corporates and their maintenance activities, i.e. levies.

3 REGULATORY FRAMEWORK IN SOUTH AFRICA

In this section, we outline briefly how the use of deferred ownership instruments is catered for in South Africa's regulatory framework. Deferred ownership is touched on by an array of regulations, which will have an impact on the risks that agencies involved will face and the way they can manage that risk.

The extensive regulation around consumer protection is well balanced by regulations that protect the interests of both developers and finance providers. However, we largely confine ourselves in this chapter to consumer protection regulation. Therefore, most of the evaluation is largely from the point of view of the buyer. There is a web of laws especially concerned with consumer protection, but we will be focusing on three key acts: The Alienation of Land Act 68 of 1981 (ALA), the National Credit Act 34 of 2005 (NCA) and the Consumer Protection Act 68 of 2008 (CPA).

Our analysis is also largely confined to the instalment sales instrument. The regulation of the lease option instrument is complicated by the option agreement, which comes into effect at the end of the lease period. An option agreement binds the seller to sell the unit to the signatory, the aspirant buyer, after a defined period of leasing. The option agreement usually includes an offer to purchase, which is conditional upon the aspirant buyer accessing the necessary finance. It is not, however, clear that the aspirant buyer will be protected to the extent instalment sales buyers are protected in the ALA. An analysis of option agreements is beyond the scope of this research paper, as it requires special legal knowledge. The lease part of the agreement will be subject to rental regulation, which is not the subject of this paper.

Other types of regulation also of relevance, but not explored in detail in this report, are:

- public-sector financing regulation, should government become a direct provider of deferred ownership units
- tax legislation, as the sale and acquisition of property often leads to tax liability for the agencies involved
- tenure legislation, such as the Sectional Title Act 95 of 1986, as tenure arrangements may have implications for the maintenance of properties and payment of fees for the upkeep and operation of property, and Prevention of Illegal Eviction from and Unlawful Occupation of Land Act 19 of 1998 (PIE)
- Insolvency Act 24 of 1936.

3.1 The Alienation of Land Act 68 of 1981[29][30][31]

Instalment sales are specifically regulated by the ALA[32], an act which also includes general provisions for the alienation of land (sale, donation and exchange of land). Chapter II of the ALA relates specifically to instalment sales, but there are also relevant provisions in the other two chapters of the Act. Instalment sales agreements in which the state is the seller fall outside of the ambit of the ALA, although, very importantly, companies owned by the state, in whole or part, are covered by the Act.

Instalment sales are defined as those sales of residential property where the minimum maturity period is more than a year, and three or more instalments are specified in the contract or agreement. The ALA refers to an instalment sales agreement as a contract or an agreement. These terms are used interchangeably below and throughout the paper.

An array of interrelated provisions and mechanisms have been set up to protect instalment sale buyers, for reasons discussed above in Chapter 2. Most of the key provisions (but by no means all) are identified and explained below[33]. The NCA also contains relevant provisions, as an instalment sales agreement is a credit agreement in terms of the NCA[34]. Only if NCA provisions conflict with ALA provisions should the NCA provisions prevail, otherwise the NCA and ALA should work together. According to a Constitutional Court (CC) case, where the ALA does not conflict with the NCA, NCA and ALA need to be read together. We identify a number of these overlaps below and attempt to provide the legally sound interpretation of the provision that prevails.

a) A preferent claim assigned to the buyer in the case where the seller is insolvent or the land is attached in execution of debt incurred by the seller, and other related rights

If the property is sold in execution[35], the buyer is given a preferent[36] claim on the proceeds of the sale of the property. Although, in the case where one of the claimants is a mortgagee (mortgage provider) of a mortgage registered over the property prior to the signing of the ISA (which we can term prior mortgages), the preferent claim is second to the claim of the mortgagee (section (20 (5)). Mortgagees of mortgages registered subsequent to the ISA enjoy no preferent claim (section 9(8)).

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[29] Discussion mainly drawn from Kelly-Louw, M. 2014. Consumer credit. In W.A. Joubert and J.A. Faris (Eds.) The law of South Africa. Volume 8, 3rd edition. Paragraphs 185-226.

[30] Discussion also drawn from Patrick Bracher, Director, Norton Rose Fullbright, personal communication, 14 November 2019.

[31] Discussion also drawn from Brits, R. 2016. Real Security Law. Cape Town: Juta.

[32] Act available at https://www.gov.za/sites/default/files/gcis_document/201503/act-68-1981.pdf

[33] Assumes the seller is the owner and there are no intermediaries or remote purchasers. The Act has specific provisions for chains of buyers and sellers where transfer is not effected at each transaction, except for the final transaction. These provisions are beyond the scope of this report, although in some instances may be relevant. They add considerably to the complexity of the Act.

[34] Paragraph 210(l), LAWSA, 2014.

[35] Presumably sales in execution also include foreclosure by the mortgagee.

[36] Preferent claim: section 1 of the Insolvency Act states that "preference, in relation to any claim against an insolvent estate, means the right to payment of that claim out of the assets of the estate in preference to other claims; and 'preferent' has a corresponding meaning".

The buyer is also given the right to avoid the sale in execution of the property altogether and take transfer of the property, subject to the payment of monies owing for the sale of the property (section 22(1)). The monies owing are the larger of either:

1) all amounts owing to the seller on the ISA, or
2) the sum of i) the costs of attachment or sequestration; ii) any endowment, betterment or enhancement levy or similar on the property and iii) amounts due on only the mortgage (or mortgages) registered on the property prior to the ISA[37].

b) Requirements for the "registrability" of the property and the "recording" of the Instalment sales agreement (ISA) or contract

The ALA requires that **before any instalments of capital and interest (termed "considerations" in section 1) can be charged and collected by the seller**, the ISA must be **recorded** by the Registrar of Deeds in the Deeds Office, **and the property must be "registrable"** (section 26(1)). Recording entails having the title deed of the underlying property, which is sold by instalment, endorsed by the ISA. Property is registrable when it is capable of being registered as a subject of a separate title deed in the deeds register. To be capable of being registered, the land must have gone through the process of subdivision, i.e. designated within an approved general plan, placed within a township register open at the Deeds Office, and be surveyed and pegged. Technically, it would be possible to register contracts against the mother erf and for the properties still to be registrable. However, such an arrangement would be very inefficient if there is only one deed for the mother erf and recording can thus not be achieved in parallel. The use of "certificates of registered title" for each of the properties would be more efficient and would provide parties with the assurance that the properties are registrable, as the preconditions for the certificate amount to registrability of the underlying property.

The recording of the ISA gives the buyer the exclusive right to take transfer of the property and puts third parties on notice, including creditors of the seller, regarding the preferent claims afforded the buyer.

If the seller has not recorded the contract within 90 days of signing it if the land is registrable or, if not registrable, within 90 days of becoming registrable, the buyer can record the ISA when the property is registrable, or within 14 days of the end of the 90-day period, cancel the agreement (section 20 (1) (a).

Section 20 (1) (a) thus implies that the recording of the contract needs to be against the individual, separate title deed of the property being sold (i.e. alienated).

In the absence of recording and registrability of the property, the seller can only collect payments for occupational rent, property rates and insurance payments, etc.[38] The time limit for the property being sold by instalment and not being registrable is set in the ISA at five years (section 6(4)). Thereafter, the buyer may cancel the ISA.

[37] According to section 9(8) of the ALA, a mortgagee of a mortgage registered subsequent to an ISA is deemed to "have consented irrevocably and unconditionally in favour of the purchaser whose contract was recorded … to the discharge of the mortgage bond or the release of the land from the bond (section 9(8)). In addition, section 22(1), when referring to the amounts due on mortgages on the property, cross references section 9(3), which in turn refers to mortgage(s) with which the property is encumbered at the point when the parties enter into the ISA (section 7(1))."

[38] Paragraph 208, footnote 10, LAWSA, 2014; and section 1, ALA.

In the absence of recording and registrability, sellers cannot collect considerations directly. However, buyers can elect to forward capital and interest payments to a trust account (of, for instance, an estate agent), or to the seller if such payments are covered by an irrevocable and unconditional guarantee provided by a bank or a registered insurer. If the seller becomes insolvent before recording and registrability is achieved, the payments become payable to the buyer immediately.

c) Disclosure of mortgages on the property and provision of certificates of disclosure by mortgage providers etc. and the rights of buyers to take over mortgage payments

The Act also seeks to protect the buyer in the case where there is a mortgage on the property registered prior to the ISA and the mortgagee thus has a preferent claim to the buyer. "The Act has an almost staggering network of provisions in chapter II aiming at informing the parties, and in certain situations keeping them informed, of the various transactions concluded regarding the land, the various parties involved, and their financial position vis-à-vis each other"[39]. These networks ultimately allow the buyer to be informed about whether the seller is honouring a mortgage payment registered prior to the contract. For instance, according to section 9(1) the buyer must notify the mortgagee about the ISA, where the notification entitles the buyer to notice of any legal proceedings against the seller (the mortgagor) by the mortgagee according to section 9(2). Additionally, the buyer can ask the mortgagee for a certificate regarding the remaining balance in the mortgage bond and the rate of interest three times per calendar year (section 9(6)).

The Act also gives the buyer a right to take action, in that he or she can take over payments of mortgages registered prior to the contract from the seller (section 11 (c)), and thus perhaps limit the claims of these prior mortgages and costs of foreclosure, sequestration etc. Should a buyer step in and make a payment to the mortgage provider, the payment discharges the debt between buyer and seller. ALA section 11 (1) c) states "the owner is not entitled to recover again from the [buyer] … any payment made in good faith by the buyer on behalf of the owner to any mortgagee….".

d) Limitations on the price of property in relation to mortgages registered prior to the contract

The Act also gives the buyer the option to avoid the risks related to relatively large prior mortgages being held on the property by the seller. According to 7(3)b, if the sum of the value of the prior mortgages held on the property is greater than the selling price (in the ISA), the buyer can cancel the contract within 14 days of the receipt of the certificate on prior mortgages required of the seller.

e) Limitation on interest rates and interest charged

The Act gives precise instructions as to how the interest should be calculated, and the periods over which it can be charged. A maximum rate of interest is also provided for. The latter is an interest rate prescribed by the minister in regulation from time to time in respect of contracts of various classes (section 12(1) read with section 31(1) c).

f) Precision on the items and amounts that buyer (and seller) can recover should the contract be cancelled or be determined void

The ALA indicates the items that can be recovered by the buyer or the seller should be the contract be cancelled by either party.

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[39] Paragraph 196, LAWSA, 2014.

According to section 28 of the ALA, if an ISA contract is cancelled, any of the parties who has performed partially or in full can recover his or her performance. "Performance" is not defined in the Act; for the buyer it is taken to mean **payment made that redeems the capital owing (i.e. capital payments)**.

In addition to his or her performance, the buyer can recover the following from the seller:

i) Interest payments at the maximum rate prescribed in the ALA (i.e. see below for the maximum interest rate).
ii) Reasonable compensation for spending by the buyer to preserve the land or improvement on the land and spending, undertaken with express or implied consent of the seller, that enhanced the market value.

While the seller can recover:

i) Reasonable compensation for occupation and use of the property.
ii) Compensation for damage caused intentionally or negligently to the property by the buyer or person for whose action the buyer is liable.

As part of his or her performance, the seller can also recover the amount of capital the buyer still owes on the property.

g) Clarity on the grounds for cancellation of the contract

Regarding the cancellation of the contract **by the buyer**, at least the following grounds have been mentioned in the Act:

- At initial stages of the contract, when the sum of the amount owing on prior mortgages held on the land is greater than the selling price (7(3)b).
- When information in the form of mortgagee certificates about the amount owing on prior mortgages is not made available within the statutory periods (7(3)a).
- When the ISA/contract is not recorded or the property is not registrable within the statutory periods (section 20 (1) c).
- When the buyer requires transfer of the property because the terms of the contract have been completed or the buyer has met the conditions of transfer in the case of seller insolvency or when the land is attached, but the transfer has not taken place (22 (1)).

Upon cancellation, the parties can recover payments made to date in line with section 28 of the ALA.

h) The contents of an Instalment sales agreement (ISA) between buyer and seller are prescribed

The ALA prescribes both what needs to be included as a minimum within ISAs and what type of provisions must be excluded from agreements (section 6 and section 15 of ALA respectively).

The prescribed content requirements for agreement that may benefit the buyer include the following:

- The need for the seller to disclose the details of all mortgages held on the property. Disclosure should be in the form of certificates delivered within 30 days of the conclusion of the contract, according to section 7(1).
- Details of the payments required, including the annual rate of interest, the amount of each instalment and due date for each instalment.
- In section 6(1)(m), the date on which the buyer can take possession and occupation of the property and when the "risk, profit and loss of the land" shall pass to the buyer. Importantly, this

term includes tax liabilities associated with the property (e.g. the property rates) and any gains in the capital value of the property through the workings of the market (i.e. capital gains).

- Date on which the property will be registrable (if the land is not subject to a separate title deed at the time of the contract).
- The undertaking by the seller that the property will not be encumbered or further encumbered by a mortgage between the signing of the ISA and the recording of the ISA.
- A range of provisions in the Act that give protections to the buyer including a number covered in this explanation.
- A reference to, among other things, the right of the purchaser under section 17 to accelerate payments in terms of the contract and claim transfer against simultaneous payment of all outstanding amounts to the seller.

Prohibitions for the ISA include the following:

- Forfeiture by the buyer of claims in respect of spending to preserve the property, with or without the consent of the seller, and in respect of improvements which enhance the market value of the property with the express or implied consent of the seller.
- Any provision disallowing the buyer from claiming transfer if the buyer accelerates meeting his or her obligations in terms of the contract.
- Obligations placed on the buyer to accept a mortgage arranged by the seller for amounts owed by the buyer in terms of the contract, except where the mortgage offered is competitive in the market in relation to the amount owing and the kind or class of property which is subject to the ISA.

A court is given wide ranging powers to intervene if a contract does not "substantially comply" with the requirements in the ALA. The most likely court to intervene is a magistrate's court[40]. According to section 24, a court can:

- reduce the interest rate of the instalment loan to what the court deems just and equitable
- grant an order of rectification of the contract
- declare the contract void from the outset of the contract period
- grant such alternative relief as the court may deem fit.

i) The need for statements of account

The Act provides for both the frequency and the content of the statement of the loan account that the seller is obliged to hand or send to the buyer (section 16). The Act gives the minimum frequency as once per year, but read with the NCA, the minimum frequency is every six months[41].

The statements are required to reflect the following items (16 (2)):

- the interest and other costs accrued in terms of the contract over the period covered by the statement
- the allocation of payments made during the period by the buyer to capital, interest and other separate cost items
- the balance of the purchase price and other costs owing at the end of the period after payments are considered

[40] Paragraph 194, LAWSA, 2014.

[41] Paragraph 202, footnote 2, LAWSA, 2014.

- the amount payable on any endowment, betterment or enhancement levy at the end of the period
- if the land is encumbered by (prior) mortgage bonds, the amount owing by the seller on each of the mortgages over the period.

The Act penalizes the seller for not performing their obligations on statements, but the penalty requires the action of the buyer (section 16(3)). The buyer needs to demand a statement in writing, giving a 30-day notice period to receive the letter. If the buyer does not receive the statement from the seller within the period, he or she is not liable to pay interest from the period of posting the letter until the receipt of the statement.

j) Provisions for breach of contract and cancellation of contract

The Act prescribes how the seller should inform the buyer that he or she is in breach of contract by way of a notice, especially the period over which the buyer must remedy the contract before the seller can take action, including cancelling the contract (i.e. the notice period). According to section 19, notice periods vary according to the number of notices given within a calendar year. The first two notice periods are 30 days from the date delivered (by hand or registered mail) and, thereafter, are the usual seven days.

Notices need to include details of:

- the buyers alleged breach of contract
- the demand the breach be rectified within the notice period
- the steps the seller intends to take if the breach is not rectified.

After the notice period, should the seller wish to cancel the contract, they are required to send a separate notice to the buyer indicating they are cancelling the contract.

The NCA gives additional content to the notices of breach provided for in the ALA. Breach notices (section 129(a) notices in the NCA) need to indicate that the remedies to which the buyer has recourse (i.e. the buyer can refer the contract to a debt counsellor, alternative dispute resolution agent, consumer court or Ombudsman with jurisdiction)[42]. Buyers need to be in breach of the ISA for at least 20 business days before a NCA section 129(a) notice can be sent (there does not seem to be an equivalent period in the ALA) and the seller can only act after 10 business days after the buyer has received the notice (the court can be approached to institute legal proceedings to collect a debt or the agreement can be cancelled and the accompanying claim for repossession of the property instituted). The last provision essentially means that in any year, the third notice period and any subsequent periods must be 10 days.

k) Rights for the buyer to accelerate payments and, after 50% of the capital has been repaid, to take transfer of the property

The Act gives the buyer the ability to limit interest payments over the course of the instalment sale loan by increasing payments so that more of the capital is redeemed every month and interest payments subsequently reduced. This is provided for in section 15 (1)(f) which prohibits the seller from withholding transfer if the buyer accelerates the discharging of his or her obligations and claims transfer before the end of the period indicated in the contract.

Furthermore, after 50% of the capital has been redeemed, the buyer has the right to take transfer of the property (subject to paying the seller for the remainder of the property value) (section 27)

[42] LAWSA ibid

and register a mortgage for this purpose. There is a proviso for this right: the conditions as to the interest rate and redemption in the mortgage may not be more onerous than the conditions which applied in the ISA (section 27(2)).

The buyers thus have strong powers to gain full ownership of the property should their financial position improve over the course of the ISA.

l) Responsibility for the maintenance of the property and property rates and service charges

The ALA contains nothing specific about the responsibilities for the maintenance of the property. According to the ALA 6(1)m "the risk, profit and loss of the land" passes to the buyer on the date specified in the contract, usually the date of occupation. Once risk passes, the buyer has the obligation for the upkeep of the property and the payment of all rates and property tax. The Act places no enforceable obligation on the buyer to see that the property is kept intact unless there is such a clause in the contract.

If the ISA is cancelled, the buyer may claim spending incurred to maintain the property, but not on improvements that enhance the value of the property, unless the seller gave his consent for this expenditure.

Although the buyer may be responsible for the payment of property rates, whether or not the municipality is compelled to hold the buyer responsible for payment appears to be unresolved. The debate may pivot on whether section 6(1)(m), in relation to the "risk, profit and loss", can take effect on a date only determined by the nomination of the seller, or whether the property needs to be registrable and the contract recorded against the individual title deed of the erf in question. Given section 26(1) (see b) above), in which the seller cannot charge instalments before registrability and recording, and can only charge occupation-related rent, suggesting that before recording and registrability the seller has a status akin to a landlord, it would seem that the municipality should tax the seller and not the buyer.

m) Cooling off period

The standard cooling off period that applies to normal residential property is applicable for instalments. In terms of section 29A of the ALA, a buyer may reconsider the contract and cancel it unilaterally and lawfully within 5 working days of signing the contract. The period is fiveworking days, excluding the day on which the contract was sign. The period only applies to property sold at a price of R250 000 or less.

n) Accelerated payments and taking transfer

The buyer is entitled in terms of section 17 of the ALA to make earlier and larger payments than agreed to in the contract. In terms of section 17(c), the buyer can also pay up the remainder owing according to the contract and claim transfer. If the land is registrable at the time, then the seller must transfer the property to the buyer.

3.2 National Credit Act 34 of 2005

The National Credit Act[43] regulates all credit agreements, including instalment sales, and the sales agreement that follows the lease agreement in a lease option arrangement (section 8). A credit agreement is any agreement in which there is a charge, fee or interest payable to the credit provider. An instalment sales agreement falls within this definition.

We consider only the key relevant provisions for the NCA in this section.

A credit provider must:

- According to section 40(1) of the NCA, register with the National Credit Provider, if it undertakes 100 credit transactions or provides a total credit of R500 000 or more (40(1)a).
- Conclude a pre-agreement statement (section 92(1&2)) and quotation (section 92(1), (2)b, (3) and (4)) with the borrower for every credit transaction it enters into. A pre-agreement statement can be the proposed agreement itself or another document that lays out the terms of the credit agreement (form determined by section 93). A quotation must contain the principal debt, how that debt is to be distributed, the interest rate and other credit costs, the total cost of the proposed agreement and the costs that the creditor would be entitled to if the consumer cancels the contract.
- Conduct a credit assessment for every credit transaction (section 81). In such an assessment, the credit provider must check that the borrower understands the cost of the credit, and risks, rights and duties associated with the loan (81(2)(a)(i)). Second, the credit provider must assess the credit history (81(2)(a)(ii)) and financial position (81(2)(a)(iii)) of the borrower to check for their payment track record and ability to service the debt. Third, if the buyer's ability to get credit is linked to a business venture, an assessment of the likely success of the venture is required (81(2)(b)). The latter would be relevant if the instalment sale is a purchase of a residence which will also be used as a business premises. Reckless credit agreements are prohibited (81(3)), and an agreement is considered reckless if there is no credit assessment and/or the buyer is overindebted (80). Under section 83 of the Act, the court can set aside agreements considered reckless until they are rectified.

Section 125 states that a consumer can settle a credit agreement at any time without advance notice by paying the settlement amount to the credit provider. However, in certain circumstances a borrower may incur penalties for early settlement. The amounts listed in section 125 required to be paid by the consumer to the creditor to settle the credit agreement include:

- the unpaid balance of principal debt at the time of settling
- unpaid interest charges and all other fees/charges payable up to settlement date
- for large agreements (i.e. over R250 000) such as most mortgages or property related instalment loans, an **early termination charge** no more than the prescribed charge, or if there is no prescribed charge, equal to no more than the interest that would have been payable under the agreement for a period equal to the difference between **three months** and the period of notice of settlement if any is given by the consumer.

[43] Act available at https://www.justice.gov.za/mc/vnbp/act2005-034.pdf

Section 126 stipulates that a consumer can prepay any amount still owing to the credit provider, which the credit provider must accept and record on the date of receiving the payment, including payments to reduce the principal debt.

Section 102(1) allows the mortgage provider to include registration, initiation, extended warranty and credit insurance fees in the principal debt. The provision is extended to lease agreements, secured loans and instalment agreements for moveable assets. Instalment agreements for fixed property are not included and the inference is that the provision does not apply to such agreements. By implication, therefore, mortgage loans can include a range of the transaction costs involved in the property sale in the principal loan amount, whereas the type of instalment sales discussed in this report cannot. Section 102(2) limits the amounts charged for registration, etc. to the actual amounts payable by the credit provider to the providers rendering the service.

3.3 Consumer Protection Act 68 of 2008

The Consumer Protection Act[44], which came into effect in March 2011[45], regulates transactions defined by the Act between a consumer and supplier who promotes and sells services or goods to generate an income in South Africa. A transaction involving a property owner who sells her home privately to a willing buyer is excluded from coverage by the Act. Transactions in which a seller enters into transactions dealing in immovable property regularly as part of their ordinary business are covered.

CPA provisions that would apply here, include the following[46][47]:

a) The agreement must be in plain and understandable language (section 22).

b) The agreement must contain fair, reasonable and just terms (part g, sections 48-52). A supplier may not offer to supply services or supply goods at a price that is unfair, unreasonable or unjust or on terms that are unfair, unreasonable or unjust.

c) The consumer has the right to receive express notice of any term in an agreement which limits the risk or liability of the provider, or of any term which constitutes an assumption of risk or liability by the consumer.

d) The consumer has the right to return defective goods, which effectively removes the voetstoots clause, according to sections 55 and 56.

Point d) probably holds very important implications for deferred ownership transactions that could impact positively on the quality of building.

Section 55(2) of the CPA provides that all goods must be reasonably suitable for the purposes for which they are generally intended, of good quality, in good working order, and free of any defects. The goods must be useable and durable for a reasonable period, having regard to the use to which they would normally be put and to all the surrounding circumstances of their supply. When a defect is present, it means that the product lacks the quality promised in terms of the sales agreement.

According to section 56(1) of the CPA, any transaction or agreement is subject to an "implied warranty" by the producer, retailer or supplier, to the effect that any products produced, supplied or distributed should comply with the quality requirements and standards, meaning they are free from any defects. There are limitations to the warranty: it is not applicable if the consumer was informed of the specific condition of the products and the consumer expressly accepted the product on that basis, or knowingly acted in a way compatible with accepting the product in that condition.

According to 56(2) of the CPA, a consumer may return the product to the supplier within six months, without penalty, at the supplier's risk and expense. If the product is returned, a supplier must, at the direction of the consumer, either repair or replace the defective products, or refund the purchase

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44 Act available at https://www.gov.za/sites/default/files/gcis_document/201409/321864670.pdf

45 Van Heerden, A. 18 April 2019. Consumer Protection Act: How does it affect property transactions? RNews. https://www.rnews.co.za/article/24148/consumer-protection-act-how-does-it-affect-property-transactions

46 Dykes van Heerden Group. 12 November 2014. The Consumer Protection Act and typical property transactions. https://www.rnews.co.za/article/24148/consumer-protection-act-how-does-it-affect-property-transactions

47 Smith, 2019.

price, provided that if a supplier repairs the returned product unsuccessfully, the supplier is obliged, within three months thereafter, to repair, replace or refund the consumer the purchase price of the returned product.

3.4 National Home Builders Registration Council

The National Home Builder Registration Council[48] was established in 1998 under the Housing Consumers Protection Measures Act 95 of 1998[49]. Under the Act, construction companies and developers must enrol construction projects for new residential construction. Enrolments occur at project level for engineering services and at the home level for the house. Enrolment enables the Regulatory Council to monitor and moderate the construction projects to ensure sound building and to issue defined length warranties to the buyers of properties for structural defects. Only construction projects built by a company registered with the NHBRC can be enrolled. Building companies that meet the prescribed industry standards criteria in terms of technical competence, construction experience and financial capability will be registered. Moderation of the construction process occurs through an inspection regime in which inspectors can stop building and insist on demolition and rebuilding, and issue fines for noncompliance. A key sanction is deregistering or "black-listing" builders and engineers. The inspectorate also randomly surveys building sites to check for enrolments and registration.

All defects are also supposed to be eliminated through the NHBRC inspection process. A one-year warranty is provided for major structural defects related to the roof and five years for all other structural defects. Warranty is issued in the form of a "final unit report" following the completion of the project.

The NHBRC warranty only comes into play if the original contractor cannot fix the fault, and an owner with a complaint is required to first contact the original contractor to seek remedy. Only if the contractor is liquidated or unwilling or unable to remedy the defect, will the NHBRC step in to remedy the situation. The NHBRC also uses the threat of black-listing contractors as a means of holding the contractor to account. Essentially, if the buyer of the unit is unable to get the contractor to remedy the situation, the NHBRC will seek to compel the contractor to make good on the implied warranty.

The Act is currently in a process of undergoing significant amendments which potentially gives the NHBRC more reach and resources but could substantially raise compliance costs and increase the cost of building.

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48 Discussion drawn mainly http://www.nhbrc.org.za/ and https://www.sans10400.co.za/nhbrc-qas/comment-page-1/

49 Act available at https://www.gov.za/sites/default/files/gcis_document/201409/a95-98.pdf

3.5 Other regulation or compliance issues

a) Insolvency legislation

Section 63 of the Insolvency Act[50] lays out the tariffs that trustees and liquidators are allowed to charge for various interventions to generate revenue to pay off debtors. These tariffs are presented as percentages. In an instalment sale, a liquidator will only be able to collect 3% of the gross proceeds of the sale of immovable property (subsection 2). However, in "carrying on the business of the insolvent, or any part thereof" (subsection 4), the liquidator is entitled to 6% of proceeds. Therefore, in the case of an instalment seller becoming insolvent, it would potentially be advantageous to the liquidator to maintain the contract with the original purchaser rather than terminating the agreement and selling the property.[51]

b) Compliance steps facing the Provincial Human Settlements Department wishing to implement a direct-supply model for deferred ownership opportunities[52]

The Public Finance Management Act 1 of 1999[53] has no specific provision regulating lending (only guarantees and the uptake of loans are regulated).

Any lending undertaken by the Department will need to be bound by meeting the following requirements:

1. The Province will need to be a registered credit provider in terms of the NCA. Given that the NCA is set up to regulate private credit providers, the application process may be tricky and requires investigation.
2. The Department will require a mandate from the Legislature permitting it to spend resources in this way.
3. If own/provincial funds are used, a mandate will presumably be required to seek registration with the National Credit Regulator.
4. If the Human Settlement Development Grant (HSDG) is to be used as a source of funding for the loans, funds will need to be appropriated for this express purpose and the HSDG provisions will need to be amended, i.e. conditions for the HSDG will need to be changed in the Division of Revenue Act (DORA).

To address point 4, the Department will have to argue that it is beneficial to shift more funds away from the most disadvantaged. Not getting full cost recovery and the possibility of "double dipping" (if, for instance, a FLISP is provided on top of other existing subsidies), will need to be confronted.

Furthermore, the non-payment risks will have to be acknowledged when points 2, 3 and 4 are addressed. The risk exists due to government's "abysmal" track record on collection and because government cannot enforce eviction in the case of non-payment, as case law shows that government is responsible for providing alternative accommodation in this instance. There would thus be a constant challenge regarding the drainage of resources due to non-payment.

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[50] Act available at https://www.gov.za/sites/default/files/gcis_document/201505/act24of1936s.pdf

[51] Renier Kriek, Managing Director, Combined Finance Holdings, personal communication, February 2020.

[52] James Archer, National Treasury, Budget Office, Human Settlement, personal communication, 6 November 2019.

[53] Act available at http://www.treasury.gov.za/legislation/pfma/act.pdf

3.6 Strengths and weaknesses of current regulations

As shown above, the regulatory framework provides relatively good protection for buyers. Sellers are also protected; how the regulatory framework manages their risks will be discussed at the project level in the context of the case studies (Chapter 4) and to some degree in the overall research findings (Chapter 5).

The ALA quite thoroughly addresses many of the risks of instalment buyers - there is a focus on providing the buyer with a form of security over the property being purchased. Requirements that the property be registrable and the agreement be recorded in the Deeds Office, are strict. The former wards against delays in timeous eventual transfer of the property to the buyer, while the latter prevents the sale of the property to other buyers and activates the preferent right afforded buyers where the property is encumbered. The ALA also protects the buyer's capital stake and gains in the property, should the ISA be cancelled. For example, if the contract is cancelled, the buyer is entitled to compensation for any improvements they made to the property (with the seller's permission) and any necessary expenditure on the preservation of the property (even without the seller's permission).

Should the seller become insolvent and have a mortgage on the property, the buyer's capital stake in the property is also protected to some extent by the Insolvency Act. It is in the liquidator's interest to let the buyer continue making payments to the holder of the mortgage, according to the schedule of the original contract with the seller.

A major weakness of the ALA is that it is codified in technical "legalese" and requires translation into lay language to be of greater utility to most users. Some key provisions in particular are hidden in opaque language and need to be much more broadly understood, e.g. section 28 dealing with recoverable costs in the case of cancellation of the contract.

The rule for registrability of the property is also obscured. Current regulation allows the seller to charge operational rentals when the property is not registrable, which provides a poor incentive for the seller to achieve registrability, as there is no cap placed on this rental.

Provision 6(1)(m) regarding the "the date on which the risk, profit and loss of the land shall pass to the purchaser" needs to be expanded upon. While the section is very short, it is very powerful. For instance, the section implies that the buyer carries full tax liability for property taxes. This provision is not understood by municipalities in South Africa.

A further concern is how well the ALA serves the gap market. For example, one of the provisions to ensure that the providers of mortgages to sellers do not foreclose on the property, is the requirement for the provider to issue certificates giving information to buyers on mortgage payments, arrears and balances. The Act assumes that buyers can correctly interpret the certificate and make the necessary interventions to take over mortgage payments to avert foreclosure if necessary.

The NCA is in general thought to provide good protection to debtors. The Act protects the credit buyer from being granted "reckless credit" by a credit provider, and in the case of instalment sales, the seller. Under the Act, the seller may not enter into an agreement with a buyer who cannot afford the agreement and who would become over-indebted because of the agreement. To check for recklessness, a credit provider is required to conduct a credit assessment which includes an evaluation of the buyer's propensity to pay. Reckless credit agreements also include those where the buyer does not understand the risks and obligations they are undertaking. Contested cases are to be adjudicated by the court, which can set reckless credit agreements aside. The

NCA also regulates the setting of interest rates and sets out procedures that the loan provider needs to follow when taking action against defaulting debtors.

The CPA requires that the terms of agreement between the buyer and seller be clear and stated in language that is easy to understand. Prices, too, must be reasonable and fair. In relation to a deferred ownership arrangement, a major focus of the CPA is to protect the buyer from poor building quality. Building quality is defined through the concept of the fitness for purpose. The Act gives rise to an "implied warranty" on the property, i.e. that the property is fit for purpose and has no defects. However, it is uncertain whether the buyer is adequately protected from entering into an agreement for a property with defects, as the relevant provision is not applicable if the consumer was informed of the specific condition of the product, yet still accepted it.

4 CASE STUDIES

4.1 Case Study Methodology

In this section, we conduct case studies of a number of Institutional Subsidy projects and private initiatives involving the two deferred ownership mechanisms which are the subject of the paper: instalment sale and lease option. The aim of the case studies is to highlight the key outcomes of the projects and initiatives, how they diverge from stated objectives and intentions, or how far they fall short of servicing the gap housing market and the reasons for such divergence. The purpose is drawing out lessons for introducing early subsidisation into deferred ownership initiatives. In following a case study methodology, we also aim to improve on the very limited secondary research already existing in the public domain on Institutional Housing Subsidy projects (as was reported in the HSRC report of June 2018[54]), and to begin to introduce private sector initiatives into the case study literature. Figure 1 categorises the case studies.

Figure 1: Categorisation of case studies

	Government subsidised	Privately funded
Instalment sales	Cape Town Community Housing Company (CTCHC)	Chartwell Housing Finance Solutions (Chartwell) Sentinel Homes (Sentinel)
Lease option	Social Housing Company (SOHCO) Housing Association of Blaauwberg (HAB) Amakhaya Ngoku (AN)	

We have faced substantial limitations in our attempt to use and broaden the literature. Case study information was gleaned from interviews and document review. None of the case studies had

[54] Scheba, A. and Turok, I. 2018. Review of rent to buy with a particular focus on the Institutional Housing Subsidy Programme. Report for the Policy and Research Directorate, Department of Human Settlements, Western Cape Government. Economic Performance and Development, Human Sciences Research Council (HSRC): Cape Town.

previously been investigated thoroughly. Every effort was made to consult with key informants, but given the age of some of the projects, many were no longer available to interview. Secondary information is limited and not comprehensive. While official documents for the projects were available, these related mainly to the project application and plan, not the actual outcomes of the projects. The information sources used in the case studies are summarised in Table 1 below.

Table 1: Information sources for the case studies

Case study	Main source of information – all through personal communication	Other sources of information
Cape Town Community Housing Company (CTCHC)	Werner Jurgens (Financial Manager 2008 – 2014; Chief Operations Officer 2014 – Dec 2018 of CTCHC)	• Personal communication with David Masimila (General Manager: Operations of the CTCHC) • Academic or research reports including HSRC report • Court judgements • Sample instalment sales contracts • Correspondence from the NHFC and CTCHC
Chartwell Housing Finance Solutions (Chartwell)	Paul McHardy (Executive Manager of Chartwell)	• Chartwell website
Sentinel Homes (Sentinel)	Renier Kriek (Managing Director of Combined Finance Holdings which owns Sentinel Homes)	• None
Social Housing Company (SOHCO)	Heather Maxwell (CEO of the SOHCO group)	• None
Housing Association of Blaauwberg (HAB)	None	• Personal communication with municipal officials • Newspaper articles • High Court judgement
Amakhaya Ngoku (AN)	Dr Lutz van Dijk (member of the AN Board)	• Personal communications with professionals and municipal officials • HSRC report • SHRA report

Nearly all the case studies are based on information drawn from one key respondent, who is a prominent person in the institution or company involved in the project or initiative. The information from the main source was gathered through interviews and email responses to follow-up. Interviews started in May 2019 with Chartwell, but most of them were held between September and December 2019. The main informants were also given advanced drafts of the study case to review, and their comments and corrections were incorporated into the final draft. In the case study write-ups below, we indicate the main information source at the beginning of the case study and only reference the other sources in the case study.

Each case study is unique and complicated, requiring substantial research and resources to fully understand it. Many projects are currently not resolved and have units which beneficiaries still need to take transfer of. Thus, in these write-ups and analyses, there are likely to be gaps. The aim here then is to highlight the key outcomes and reasons for these gaps for the purpose of drawing out lessons for future practice.

The National Housing Code provisions for the Institutional Housing Subsidy Programme regulates the use of the subsidy. The framework is described in Box 2. The governance framework of the subsidy is also discussed in Box 2.

Box 2: An explanation of the Institutional Housing Subsidy Programme and its governance arrangements[55]

Institutional Housing Subsidy

The Institutional Housing Subsidy (aka Institutional Subsidy) was developed to allow for the advent of deferred ownership options and forms of tenure that did not result in outright sale or transfer of property to subsidy beneficiaries. The subsidy programme was released in 1999 and first implemented in 2000[56]. Housing Institutions are the key agencies to assemble or develop the property, with investment from government in the form of capital subsidies (i.e. Institutional Housing Subsidies) and the institution's own capital being a requirement for subsidy approval. The institutions hold the property for approved beneficiaries until the beneficiary can acquire the property outright. The subsidy only follows an approved beneficiary, but the subsidy is paid to the institution early, essentially as developer capital. The subsidy is targeted at households earning R3 500 per month or below that meet the standard housing subsidy qualification criteria that apply.

Schemes can include a mix of subsidised and non-subsidy units, allowing for mix of incomes; a mix of tenure types are also allowed. The details and any changes of the mix need to be communicated to the government[57].

When the beneficiary is ready to take full transfer of the property, the Institutional Subsidy is to be converted to an individual subsidy, but prior to that the beneficiary can easily leave the scheme. After a beneficiary leaves the scheme, the institution has a limited time to find another qualifying beneficiary or pay back the subsidy to the government. In theory, record keeping of changing institutional housing beneficiaries is a simple administrative process. The rules of the Housing Code require that outright sale/transfer can only occur after a minimum of four years from occupation, although rental schemes could continue indefinitely at the discretion of the institution, with the institution able to insist on immediate purchase or give the beneficiary six months' notice that he or she is required to buy the unit in the period after the four-year minimum period has lapsed. Beneficiaries can also apply to the Department to have the Institutional Subsidy changed to an individual subsidy within the four-year period.

Housing Institutions are required to enter into agreements with the Department in which the details of the scheme are given, as well as the final arrangement for deferred ownership tenure, the sales prices, the amount of rental or instalments, and any interest rates and instalment periods. Similar details are also required in the subsidy application for the agreements between the institution and the beneficiary. The Department also requires physical and financial plans from the institution. The Code does not, however, reference the ALA in laying out its specification for Instalment Sales Agreements, nor does it refer to the recording of agreement in the Deeds Office against the current deed of the property, which is probably an oversight. Property construction, development or

[55] The information for this description is drawn from the National Housing Code (2009), unless otherwise specific.

[56] Heather Maxwell, SOHCO, personal communication.

[57] Besides outright ownership after a period (via an instalment sale or lease option), the beneficiary could rent the property from the institution or hold it as part of a share-block or co-operative scheme.

assembly/acquisition plans and location etc. are also a requirement, as well the proposed programme of progress payments for the subsidy during the construction process.

The Housing Code also sets out requirements on the legal constitution of the housing institution and its governance arrangements with beneficiaries. The government requires financial reporting and for the institution to follow "good business practice", although what this entails is not fully defined. Institutions must report on the occupation and shift of ownership of its subsidised units and continue to show that units are occupied by approved beneficiaries, up to the point that outright ownership has been achieved. Occupation certificates must be submitted as proof that the occupants of subsidised units are approved beneficiaries.

The Housing Code specifies the physical standards of the development as the ministerial minimum norms and standards and a number of forms are defined in the Code, including medium-density, multi-storey units and terrace houses, although the Code does match these to a tenure type. The Code does not provide information or guidelines on any shift from rental to sectional title, with regards to governance and the establishment of body corporates.

The Housing Code makes provision for the accreditation of social housing institutions by a suitable authority once it is established. The Social Housing Regulatory Authority (SHRA) was established in 2010 by the Social Housing Act, passed in 2008[58]. Section 13 (1) of the Act provides that all housing institutions that have received Institutional Subsidies in the past were given provisional accreditation, and thus it seems that the intention was that these institutions were to be regulated by the SHRA. It would seem that only housing institutions which intended to make use of the Social Housing subsidies fully, are registered with the SHRA. Neither the old institutions, which undertook only Institutional Subsidy projects, nor the SHRA had much enthusiasm for this arrangement of regulation, which seemed discretionary and was not incentivised. Old institutions did not wish to subject themselves to the regulatory and reporting requirements of the SHRA, while the SHRA did not wish to take responsibility for projects that seemed fraught with problems and appeared unsustainable. While there has been some rhetoric from the SHRA about extending their regulation to institutional housing projects, very limited action has been taken to assert control or promote Institutional Housing types of projects.

It seems that the above status quo was maintained since 2010 and is reflected in the lack of change in project approval and funding arrangements for projects exclusively funded by the Institutional Subsidy. The Institutional Subsidy remains the exclusive preserve of provincial departments, while funding and subsidy approval for social housing is shared by provinces and the SHRA. For instance, currently, social housing projects are funded by the Consolidated Capital Grant (CCG), together with loans and donations accessed by the housing institutions. The CCG was established in 2017 by the combining of two grants previously used to fund social housing - the Institutional Grant and the Restructuring Capital Grant. The arrangement is that the provincial department recommends the project and such recommendations are passed onto the SHRA for decision making and funding. In terms of the Institutional Subsidy project, the Department merely approves the subsidy without reference to the SHRA.

[58] The paragraphs on the role of the SHRA in regulating and overseeing Institutional Housing projects drew on discussions with Kahmiela August (Director of the Affordable Housing Directorate in the Department at the time) and Daniel Pienaar (a Deputy Director in the same directorate), but the analysis is that of the authors of this report.

Evaluation

The Institutional Housing Subsidy framework envisages that risks inherent in deferred ownership arrangements will be managed through the good practices of the housing institutions with oversight by human settlement authorities, mainly provincial human settlement departments. These departments are tasked with reviewing all aspects of institutional housing project plans when they are submitted for subsidy approval, including the agreement between the beneficiary and the housing institution. Departments are also supposed to monitor the ongoing performance of the housing institution as it operates the loan or leasing schemes.

While this oversight may be realistic for the construction phase and for ensuring building quality, provincial departments may lack competence when it comes to the oversight of revenue collection and administering loans. Managing building quality relies to a large degree on architectural and engineering review, and on progress payment subject to building inspection. Departments have the systems and capacity for this kind of action.

As our analysis of the regulatory framework has shown, the ALA has several legal provisions specifically designed for protecting buyers in instalment sales. Provisions in the ALA cover the following buyer risks: security over the asset, retaining a capital stake and benefiting from gains in capital value in the case of premature withdrawal from the agreement, and gaining actual transfer of the asset. The subsidy framework, however, makes no reference to these risks and how they should be managed. The omissions may have taken place because in practice housing institutions were publicly funded and the authorities thought that source of funding would eliminate the risk. As we will see, the courts took an alternative view, and a key housing institution undertaking instalment sales (i.e. the Cape Town Community Housing Company (CTCHC)), and, by association, their financier (i.e. the National Housing Finance Corporation (NHFC), were heavily sanctioned.

The advent of the SHRA in 2010 opened up the possibility that housing institutions and institutional housing projects may be overseen by a more specialised authority, but the SHRA has been reluctant to take on this responsibility, which may be one of the factors behind the decline of this subsidy programme.

4.2 Government subsidised instalment sales

4.2.1 Cape Town Community Housing Company (CTCHC)[59]

1. Summary details of setup

The Cape Town Community Housing Company (CTCHC), Pty Ltd company, was established as a special purpose vehicle to deliver affordable housing within the City of Cape Town area in 1999 at the advent of the Institutional Housing Subsidy[60].

In 2008, changes in the regulatory framework required the withdrawal of the City, as according to the Municipal Finance Management Act (MFMA), a municipality cannot own any share in a private company. The National Housing Finance Corporation (NHFC) became the sole owner in 2008. But this was merely a holding arrangement, as the NHFC was also required to withdraw due to the Public Finance Management Act (PFMA), which barred state entities holding majority shares in private companies. As will become clear in this report, the NHFC has faced substantial losses from its CTCHC business. Rather than shed the asset at a discounted price, the NHFC decided to wind down its CTCHC operation over time and recover what it could[61].

The CTCHC started its operations with nine separate projects in 2001 throughout the Cape Flats in the Cape Town Metro area. These projects became known as the Legacy Projects. The initial target was 5 000 housing units. Five years later the CTCHC launched the Morgen's Village Project in Mitchell's Plain, which consisted of three phases and was completed in 2013. The target number of units was 1 350[62]. The final project, for which construction with a target of 850 units[63] started in 2016, was Harmony Village, also located in Mitchell's Plain,

All CTCHC's units were sold on the basis of an Instalment Sales Agreement (ISA), with the maturity period set at one year more than the four-year minimum for the Institutional Subsidy, i.e. a maturity period of five years. As the projects progressed, however, and in line with an Affordability Programme introduced in 2004, the maturity period of Legacy Projects was raised to lower the size of monthly instalments and improve the affordability of the loan agreement for beneficiaries. The newest project, Harmony Village, was given a maturity period of up to 25 years. Morgen's Village 1 and 2 had a maturity period of 12 years, while the last phase of Morgen's Village had a maturity of 20 years. Units were made available on a full free hold basis and not sectionalised. Units are

[59] Werner Jurgens, former Financial Manager and Chief Operations Officer, CTCHC, was the main respondent.

[60] Scheba and Turok, 2018, p35.

[61] Tshangana, M. 7 June 2017. Correspondence between the National Housing Finance Corporation SOC Ltd (NHFC) and the National Department of Human Settlements.

[62] Werner Jurgens provided the following information: the total target for all Mitchell's Plain sites was 3 000 units and the total number of units built was 1 519, which included Harmony Village. The 3 000 units included a vacant site of 800. In summary: 3 000 units less 800 units on vacant land and 850 for Harmony Villages leaves 1 350 units for the Morgen's Village project. A total of 670 units were built in Morgen's Villlage, leaving a shortfall of 680. This figure is close to the figure indicated by Werner Jurgens (661).

[63] Information provided in spreadsheet by David Masimila, December 2019.

standalone, single or double storey residential, without shared, communal space. All communal space is open to the public and is the responsibility of the municipality[64].

The CTCHC used a mix of housing subsidy funding: public funding from the municipality, and loan funding made available from the NHFC.

Financing displayed the following trends:

- Over the course of the project phases, the **Institutional Subsidy** grew substantially, from R18 600 in 2000 to approximately R27 700 in 2005 before the Morgen's Village project, and finally to between R83 000 and R115 000 during the course of the Harmony Village project between 2013 and 2015[65]. The total amount in subsidies made available has not been discussed in reports that are in the public domain.
- **Municipal land contributions** were somewhat opaque in the Legacy Projects phase. Municipal land was made available for the nine projects; however, no land availability agreement (LAA) was set up at the time, and the price was subject to ongoing negotiation during construction. The land price was finally settled in 2006 at about R2500 per plot on average at the point when the land transfer issue was being resolved, which seemed to have been about half of the market value[66]. It is not clear to what extent the land was adequately serviced for the housing units, whether any contribution to servicing was made by the City, or whether servicing was funded through the NHFC loan.
- By the time of the last phase of Morgen's Village, the municipal subsidies were substantial, consisting of:
    - land from the City at discounted prices
    - serviced site subsidies at approximately R40 000 per site
    - a subsidy for underground electricity
    - a discount on submission of building plans for subsidised housing to the City
    - a refund for enrolment with NHBRC
    - developer charges negotiated with the City.
- **NHFC loans** to the CTCHC have not been quantified in any of the available literature. Loans were provided for Legacy Projects, Morgen's Village and Harmony Village, but were secured by the NHFC through mortgages held over the mother erven only in the case of the latter

[64] Summative information based on personal communication with David Masimila, December 2019, and Werner Jurgens.

[65] The HSS was used to verify the value of Individual Subsidies provided. We used the value of subsidy approvals for individuals in the relevant Institutional Housing projects recorded on the HSS.

[66] Zweig, P. 25 July 2006. *The Cape Town Community Housing Company: The registration of land process in their first eight housing developments and implications for the transfer of ownership to beneficiaries.* Environmental and Geographical Science Department: University of Cape Town.
This report was developed under the auspices of Sophie Oldfield of the Department of Environmental and Geographical Sciences, University of Cape Town (UCT) as pro bono work for the Legal Resources Centre (LRC), which was later involved in the courts representing a group of buyers in the Legacy Projects.

two projects. In the case of the Legacy Projects, the land was owned by the City at the time the loan was taken, and a mortgage was not put in place.

As laid out below, a substantial once-off publicly funded capital injection, in the order of R89m, was made into the Legacy Projects between 2006 and 2009 to address perceived lapses in building quality[67].

2. Summary of outcomes

The main outputs and outcomes of the CTCHC projects are outlined in Table 2.

Table 2: Key aspects of performance of CTCHC projects[68]

Project name	Commencement and end date of project	Number of units built	Number of accounts settled	Percentage settled
Legacy Projects (maturity period: 48 -60 months)				
Heideveld	2001 - 2002	80	79	98.8%
Luyoloville (Gugulethu)	2001- 2002	246	72	29.3%
Manenberg	2001- 2002	280	252	90.0%
Newfields (Hanover Park)	2001- 2002	412	290	70.4%
Railway (Hanover Park)	2001- 2002	317	289	91.2%
Pylon (Hanover Park)	2001- 2002	93	93	100.0%
Philippi /Stock Rd site	2001- 2002	605	214	35.4%
Eastridge (Mitchell's Plain)	2001- 2002	347	203	58.5%
Woodridge (Mitchell's Plain)	2001- 2002	80	79	98.8%
Sub Totals		**2460**	**1571**	**63.9%**
Newer projects (maturity period: 144 – 300 months)				
Morgen's Village 1	2004 – 2005	92	78	84.8%
Morgen's Village 2	2006 – 2008	237	168	70.9%
Morgen's Village 3	2009 - 2010	341	108	31.7%
Harmony Village	2013 - 2015	849	69	8.1%
Sub Totals		**1519**	**423**	**27.8%**
Total		**3979**	**1994**	**50.1%**

Sources: CTCHC, HSS and own calculations

As can be seen from the table, over the course of its history, CTCHC built a total of 3 979 units, of which about 62% were built in 2001 as part of the Legacy Projects. To date, 50% of all buyers have paid off the capital on their accounts, of which 64% were buyers in the Legacy Projects. Given that maturity periods, as defined by CTCHC, have lapsed a long time ago, this performance is quite disappointing. CTCHC has reported that in the clear majority of cases, the loan account was settled by transfer to the original beneficiary or his or her deceased estate. Accounts were settled by the transfer of units to a third party only in about five instances.

[67] David Masimila, General Manager: Operations of CTCHC, personal communication, December 2019.

[68] Based on information provided by David Masimila, augmented by information on HSS to glean start and end date.

About 49% of the building target was met in the Legacy Projects.

Some **Legacy Projects** have performed substantially below the average rate of settlement of 64%. The settlement rate may be related to property market performance, with areas that experienced big price increases displaying higher settlement rates – Philippi and Gugulethu have low rates, while Hanover Park and Mitchell's Plain have higher rates. Other possible reasons for this rate will be discussed below. The CTCHC reports that it is owed about R32m by buyers[69].

Newer projects seem to be performing substantially better. According to the table above, it seems that the shortfall in the number of units built against the building target was 680 units.

The somewhat older projects (Morgen's Village 1 and 2), have an average settlement rate of 75%, with CTCHC reporting that R5m is currently outstanding from buyers.

In 2016/17, the NHFC gave its accumulated losses as R28.4m, with its annual losses that year at R14.3m[70]. This figure was up from the accumulated losses in the previous financial year which amounted to R20.1m. As will be seen below, there is also uncertainty about how arrears built up between the CTCHC and the City for the utility bill. Depending on how these arrears are settled, the CTCHC may face further losses.

The picture of buyer's arrears and amounts owing has, however, been clouded by Constitutional Court (CC) findings made in November 2018[71]. The CC case followed a Cape High Court Case from 2016, when a group of buyers instigated an action against the CTCHC for cancelling their ISAs due to non-payment and selling the properties to a third party[72].

The CC found that because the CTCHC failed to record the ISAs with the buyer against the title deeds of the properties until 2014, the CTCHC was not permitted to collect instalments of interest and capital before that date[73]. The CTCHC was only permitted to collect rent prior to the recording in 2014. CTCHC has reportedly had difficulty interpreting the findings of the CC and understanding how it should view payments made before recording in 2014.

The CTCHC current reading regarding the payments made by buyers prior to recording is as follows[74]:

- All the payments that the beneficiaries made up to the point of recording will be taken as capital payments and they will be deducted from the capital amount owed by the beneficiaries.
- The provisions that were made through the Affordability Programme (see below) fall away, except for the interest of 12.2% that will still be charged on the loans.
- The beneficiaries will be given a period of 12 months to settle any outstanding debt and take transfer of their properties.

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69 David Masimila, personal communication, December 2019.

70 Annual Financial Statements for 2016 and 2017, as quoted by Werner Jurgens in email, 3 March 2020.

71 David Masimila, personal communication, December 2019.

72 Explained as background in Mhlantla, J. 28 November 2018. Cape Town Community Housing Company (PTY) Ltd v Women's Legal Centre Trust. Constitutional Court of South Africa. Case no CCT 212/17.

73 There was another finding relating to the premature issuing of the section 129 NCA notices following the recording of the ISA indicating the ISAs were being cancelled. Given that the instalment payment arrears could not exist before recording, any arrears had to be established after recording, before notices of arrears could be delivered. Furthermore, those in arrears had to be given time to address their arrears through debt counselling, etc. before action could be taken against them (Mhlantla, 2018).

74 David Masimila personal communication, December 2019.

- All the debt owed by the beneficiaries will be recalculated based on the date of recording of agreements and the amounts due will be communicated to the beneficiaries. After recalculation, the R32m owed on the Legacy Projects may be reduced substantially (the amount owing is estimated at R20m) and in some cases the CTCHC will have to reimburse beneficiaries. The CTCHC has established that there are some beneficiaries who have already paid up and will only need to pay the R600 in conveyancing fees to take transfer.

The losses incurred by the CTCHC from the CC finding are not clear. The arrears for buyers are in the process of being recalculated.

While the CTCHC is still a going concern, it is busy winding down its operations. At the time of the High Court challenge, when losses were assessed at R28.4m, and after the conclusion of the building of Harmony Village, CTCHC and the NHFC took the decision not to invest in any further projects.

3. Factors impacting performance

As will be shown, there were many factors that led to the break down in the relationship between buyer and seller, non-payment and the build-up of arrears, notwithstanding the technicalities of calculating arrears in the absence of the recording of the ISA.

3.1 Selection of buyers

The practice of recruiting beneficiaries in Legacy Projects differed in key ways to those in the newer projects.

Legacy Projects

In the Legacy Project, applicant buyers required no prior credit record or prior bank account to gain entry. Before the beneficiaries signed their instalment sales agreements, they were required to successfully complete a savings test over a certain period. There are varying accounts of the saving period ranging from between six-months and two years[75]. The savings requirement was linked to the value (and specifications) of the house the applicant wished to buy in the manner reflected in Table 3 below.

Table 3: Monthly savings requirement compared to monthly instalment amount and unit price[76]

Specifications of the desired unit	Monthly savings requirement (R)	Indicative instalment amount (R)	Price (cost minus the subsidy)
One-bedroom 40m2 unit	50	700	11 600
Two-bedroom 52m2 unit	150	No information provided	No information provided
Three-bedroom 64m2 unit	250	No information provided	No information provided
Three-bedroom 64m2 unit with ceilings and fittings	350	900	25 600

Source: CTCHC via interview

The savings scheme was marketed by a company external to CTCHC and it appears that beneficiaries were under the impression that the instalment amounts would equal the savings

[75] Zweig, 2006, p18 says six months; David Masimila, the current manager of the CTCHC, indicated that the period was two years on the basis of information he received when he joined CTCHC in 2006.

[76] Table constructed on the basis of discussions with David Masimila.

contribution. This impression seems to have existed despite the pains that the CTCHC reportedly took to indicate that the savings were not equal to the instalment. Savings amounts were much lower than instalments to enable the aspirant buyers to afford to pay for their accommodation at the time while also saving. These concepts were reportedly workshopped in detail with beneficiaries at the time. Instalment payments turned out to be at least triple the savings amount. It is not clear how the savings amounts were determined and whether the CTCHC had an accurate picture of what would-be buyers were paying for accommodation at the time. It is likely that accommodation payments varied significantly between would-be buyers. The saving scheme on its own, with its static contributions based on product specifications, thus appeared to be a poor way of gauging the affordability of instalments.

In the instalment sales contract[77], the buyer "cedes and pledges" to the seller all the buyer's "right, title and interest" to the savings as security for the "due and proper performance by the purchaser of all of his obligations in terms of and arising from this agreement", including the paying of instalments. The savings (or what is remaining) are to be released after the buyer has discharged all of his obligations.

Newer projects

A more rigorous screening process reportedly occurred in which both affordability and credit worthiness were assessed. For the Harmony Village project, the CTCHC indicated that 10 000 applicants were screened for the 850 available housing opportunities[78]

A deposit of what appears to be 4% of the difference between a) the total price of the unit (i.e. the cost of the unit) and b) the total subsidy, was also required of the buyer before they could take occupation of the unit[79]. This requirement is somewhat analogous to the savings test created for the Legacy Project, without a timeframe and the monthly tracking of contributions.

3.2 Affordability of payments

Each ISA has a schedule that shows the exact instalment amount, purchase price, subsidy and loan value, and identifies other amounts that the buyer is due to pay.

Legacy Projects

In 2001, the CTCHC signed instalment sales agreements with the beneficiaries which spelt out the terms and conditions of their contracts. The loans that were given to the beneficiaries were initially at an interest rate of 21% because of the restricted maturity period of five years. These interest rates were seen as acceptable, as the REPO rate at the time peaked at about 22% due to the financial crisis in the late 1990s. This arrangement reportedly resulted in instalments of between R700 and R900, which the CTCHC felt were unaffordable for beneficiaries at the time[80]. This perception existed, despite the fact that these instalment amounts fall within what is considered to be affordable housing payments for households at the upper-end of the monthly income threshold for

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[77] Instalment purchase agreement [for Legacy Projects] between The Cape Town Community Housing Company (Pty) Ltd and the Purchaser. 2001. Hofmeyr: Cape Town.

[78] Scheba and Turok, 2018, p43.

[79] Author's calculation based on information given in sample ISA agreement provided by CTCHC.

[80] David Masimila, personal communication, December 2019.

the subsidy of R3 500, i.e. 20%-30% of income. Presumably, a number of buyers earned substantially below the household income threshold for eligibility.

In an attempt to get the beneficiaries back on track with the repayment of the instalments, the CTCHC developed an Affordability Programme with the following elements[81] in 2004:

- a reduction of the interest rate from 21% to 12.1%
- a 28.5 % discount on the selling price of the units
- an extended and more flexible maturity period of between 6 and 12 years that beneficiaries could elect.

The impact of these measures on instalment amounts and their affordability has not been documented. Presumably, they were quite substantial. Despite these adjustments, payment levels reportedly remained low in a number of projects.

The Affordability Programme was instituted through an amendment of the agreement, which all buyers were required to sign.[82] The addendum included all the amounts adjusted by the programme and provided the buyer with a set of options for the maturity period of the loan, including corresponding instalment amounts. A choice of a six-, eight-, 10- or 12-year maturity period was offered and the buyer was informed of the remaining period on the contract in question. The amended agreement also included the total arrears in monthly payments owed by the buyer, which was added to the total outstanding capital balance.

VAT: Selling prices were inclusive of output VAT and were paid upfront by the CTCHC and recovered through the instalment payments on the overall loan amount.

Newer projects

Instalments in the newer projects are about R1 000 per month, which apparently is substantially below the rental for an equivalent unit in similar areas. Thus, in relation to the rental alternative, the units are distinctly affordable. The figure is, however, at the upper end of what is considered affordable for households earning R3 500 per month. Presumably, a number of households' incomes have escalated since 2016, making the payment more affordable. Payment rates of 98% have been reported for Harmony Village.

The monthly instalment level has been achieved with substantial subsidisation which is outlined above. In Harmony Village, based on information drawn from subsidy payment reflected in the Housing Subsidy System, the Institutional Subsidy amounted to between R83 000 and R115 644. The variation in subsidies was due to the change in the subsidy quantum over the period and a variation granted for the construction of double-storey units. CTCHC kept the loan amounts that buyers were required to pay off in instalment constant over the selling period as the unit specifications across the project were quite uniform (a 42 square, 2-bedroom unit, with double-storey units being slightly bigger to allow for circulation space). While the subsidies, including other non-top structure subsidies, may have varied, CTCHC kept the loan amount constant at R125 000. The subsidy increases essentially covered increases in building costs, and CTCHC is likely to have varied its "sales price" or "the additional amount" it generated on units if necessary, to keep the loan amount constant and all the construction costs covered. The non-institutional housing subsidies mentioned amounted to about R64 000. The "sales price" (the total amount before subsidies) was in the region of R280 000.

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[81] David Masimila, personal communication, December 2019.

[82] Addendum to Instalment Purchase Agreement for Legacy Projects, 2004.

VAT: In the newer projects, the CTCHC made savings on financing costs by applying for a directive from SARS to pay over the VAT instalments for each of the units (as the buyer pays off the capital) on the actual capital instalments paid. An initial lump sum of debt to pay SARS for VAT was thus not required, and CTCHC could pass the savings in finance costs onto the buyer by lowering instalments and interest payments (see also Chartwell case study for fuller discussion).

3.3 Building quality

Across all projects

The Agreements state that the cost of any maintenance can only be recovered by the buyer from the seller, if the seller gives prior permission in writing for this work to take place[83]. The Agreement provides that "the seller will not be required to affect any repairs occasioned by misuse and/or neglect on the part of the Purchaser". These provisions limit the amount of maintenance work that the buyer can recover from the seller, should the agreement be cancelled. Spending undertaken by the buyer that may benefit the seller if the contract in cancelled, may thus be forfeited.

Legacy Projects

The contract existed before the advent of the CPA and thus the property was sold voetstoots[84]. The seller did, however, undertake to remedy the following, provided that the buyer brought it to the notification of the seller within a specified period:

- patent defects within three months of occupation
- leaks in the roof within one year of occupation
- non-roof related latent defects within two years of occupation.

Building quality became a contentious issue in the Legacy Projects early on in the process and became grounds for grievance and non-payment amongst buyers.

In 2006, which is outside of the maximum period within which CTCHC is required to remedy defects, the CTCHC attempted to address the situation by contracting the National Home Builders Regulatory Council (NHBRC) to assess all houses built to date. The assessment cost the CTCHC R5m. According to the CTCHC, the NHBRC found that there were no major structural defects on the houses and that they had apparently fallen into disrepair due to lack of maintenance. Normal cracks due to the settlement of the building structure were evident. A rectification programme was funded by the Provincial Department of Human Settlements between 2006 and 2009 at a cost of R89 million. The NHBRC were also brought in to check the repairs after rectification. Buyers were required to sign off on both the assessments and repairs in a process facilitated by the NHBRC.

The perception of poor quality in the Legacy Projects may lie in the manner in which the Legacy Projects were implemented. A number of building standard control rules set out in City by-laws and national building regulations were not followed[85]. For instance, building plans for the development were not approved at the time and the City's building inspectors played no part in the building process. Furthermore, the normal progress payment system used in housing subsidies, carried out at the time by the Provincial Department, was not used, as subsidies were paid from the City's

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[83] Instalment purchase agreement for Legacy Projects, Hofmeyr, 2001.
[84] Instalment purchase agreement for Legacy Projects, Hofmeyr, 2001.
[85] Zweig, 2006.

budget for later re-imbursement by the Province. This arrangement was put in place because the Provincial Department lacked subsidy funding at the time.

Newer projects

Similar provisions to those in the Legacy Projects to remedy defects were put in place for Morgen's Village, except that the period of latent defects was extended to five years[86].

The contract for Harmony Village had to comply with the Consumer Protection Act (CPA) promulgated in 2008. The Agreement excludes all warranties, express or implied, except as defined in the Agreement. A similar set of defects as in the earlier agreement are mentioned: patent, latent excluding roof leaks, and latent roof leaks. The periods within which the buyer can report the defects is not clearly defined, except in the case of roof leaks. For the other defects, the agreement states that the reporting period is "at the end of completion", but the latter is not defined. The "end of completion" may refer to the end of completion of the construction of the unit, as is suggested by the use of the phrase in other sections of the agreement. That period would appear to be quite inadequate. The agreement also indicates that the CTCHC will enrol the project with the NHBRC and that NHBRC warranties will also apply. The NHBRC has a five-year reporting period for latent, non-roof related defects.

Building quality appears not to have been such a large issue in the newer projects, although the HSRC reported, from focus group meetings it had held with project beneficiaries, that they had a concern over the frequency and cost of the maintenance for the units.

3.4 Agreements

The Legacy Projects, Morgen's Village and Harmony Village each have different agreements. Agreements were signed with project beneficiaries before they were given occupation of the units. The Agreements provided a range of details for the sales price and the terms of the instalment sale/loan. The provision includes the total purchase price, total subsidy, instalment amount, the maturity period and the start and end date of the loan agreement (when the first and large instalments are due). The contracts indicate that the seller can recover property insurance premiums from the buyer. The contract for the Legacy Projects indicates that charges for property insurance, administration and community services are excluded from the instalment payments indicated, and thus can be added to instalment amounts given as separate items. Instalment amounts can also be adjusted due to changes in the prime interest rate. In subsequent contracts, some of these amounts are included in the contract and specified as "levies", with levies essentially being part of the instalments. All agreements indicate the order in which instalment payments will be allocated to cost items. The following order is given: interest, the levy and finally, the capital amount, "which is the balance of the purchase price itself". The contract makes it clear that the buyer is responsible for the "costs of electricity and water consumed at the property from the occupation date".

The Legacy Projects Agreement does not appear to indicate that the seller is responsible for the provision of statements of accounts, although in the Agreement of Morgen's Village and Harmony Village, this is indicated, and the frequency of statements of account is given as monthly.

[86] Instalment purchase agreement for Morgen's Village, Fairbridge Arderne and Lawton Inc. 2007; Instalment purchase agreement for Harmony Village, Fairbridge Arderne and Lawton Inc, 2014.

The contract assigns the responsibility for maintenance and repair of the property to the buyer and allows the seller to recover the costs of maintenance undertaken by the seller but does not mention that in certain circumstances the buyer may be entitled to compensation for maintenance, i.e. if the agreement is cancelled. Payment of rates and taxes linked to the property are also indicated as the responsibility of the buyer and included in the instalment amounts, which may be adjusted if rates and taxes are increased.

The Agreements emphasise the legislatively defined notices periods that are required of the seller when giving notice to the buyer. The permissible charges that the seller can recover from the buyer related to administration of the notice and costs of collecting arrears (default administration charges) are also covered. The agreement also references credit agreement termination charges that the seller can charge in terms of the NCA and the loss of the deposit paid by the buyer should the contract be cancelled. The process of cancellation and what each party can recover, as provided for in section 28 of the ALA, does not appear to be covered in the contract. In newer projects, the agreement does not seem to disclose the existence of mortgage held on mother erven by the NHFC. Presumably, mortgages on the property established before the arrangement would constitute a risk for buyers in that the NHFC could foreclose on the CTCHC if the CTCHC does not perform. Given that the CTCHC is currently owned by NHFC, this scenario seems unlikely now. However, should the NHFC decide to sell the CTCHC, the scenario could become more likely. The agreement also does not give details of the protections available to the buyer to ensure that he or she can adequately defend his or her property rights against a seller who may not honour the commitments to the mortgage holder. This may be in breach of the ALA.

The agreement specifies when a buyer is in breach of the contract and the steps to be followed when the contract is breached.

The **CTCHC** has reported the following set of actions it takes to comply with the National Credit Act and a typical response from consumers that seems to give rise to greater arrears. If a customer is in arrears (fails to pay a monthly instalment on time), a representative from CTCHC phones after 15 days to remind the customer of the payment due. After 30 days have passed the due date of payment, CTCHC sends the first letter of demand. After 60 days have passed, the second letter of demand is sent. After 90 days have passed the initial due date of payment, a section 129 letter can be issued, which starts the legal collection process. The section 129 letter proposes remedial action the customer can take and grants a fixed amount of time during which the customer can take such action. If the customer does not follow this advice in a timely manner, a cancellation of the agreement can be issued and the CTCHC can seek repossession of the unit through the court. However, as many customers know that the legal process only starts 90 days after defaulting, they will pay the initial arrears (the one month’s unpaid instalment that led to the first letter of demand) before the 90 days has passed, but not the subsequent months’ arrears. At this point, the process described above begins again. [87]

In various interviews with former CTCHC staff, it was stated that the CTCHC agreement allows for a key mechanism within the instalment sale option for forestalling the breach of the agreement and avoiding the build-up of arrears: the sale of the property to a third party after the four-year minimum period and the retention of capital gains and any principal paid (after any debt owing to the seller is subtracted) by the original instalment buyer. However, this mechanism is not spelt out in the examples of agreements provided by the CTCHC for review. What is specified in the contracts is that “all benefit and risk of ownership in the property shall pass to the purchaser with effect from the

[87] David Masimila, personal communication, 4 December 2019.

occupation date", which implies that capital gains accrue to the buyer, which seems to contradict the ALA. Both the former official and current official have indicated that the measure of a third-party sale has been used only very seldom across CTCHC projects.

3.5 Registrability

The recording of ISA in CTCHC projects has been discussed in section 2, above. While recording of the contract is provided for in each of the sample CTCHC agreements studied, the formulation in the newer contracts seems somewhat problematic. For the Legacy Projects, the contract assigns responsibility for recording to the seller and indicates that the buyer can "procure recording" if the seller fails to do so. In the newer contracts, recording is given as a precondition for property transfer before the end of the term of contract and the responsibility is assigned to the buyer. Recording should, however, occur as early as possible in the sales process, so that the loan instalments can be properly collected.

Legacy Projects

The agreement makes no mention of the seller's responsibility in ensuring that properties sold via instalment sale are registrable before charging and starting to collect instalments.

A minority of buyers appeared to have managed to make all their instalments within the minimum four-year period and settled their accounts and were ready to take transfer but could not do so, as transfers could not occur in 2005 as the property was not registrable. At the time the City was still the owner of the property, while the CTCHC had entered into a land availability agreement (LAA) with the City in which, at the point where the buyer could take transfer, the property was to be transferred simultaneously from the City to CTCHC, and from the CTCHC to the buyer. Such arrangements cost less in legal fees than non-simultaneous transfers but require comprehensive LAAs and a careful process of managing the granting of powers of attorney. The reasons for the lack of transfer were the subject of a detailed report undertaken by the UCT Geography Department, completed in July 2006[88]. Factors contributing to the situation proved to be complicated to address and included:

- insufficient information in the LAA between the City and CTCHC, including the determination of the sale prices for the units to be subdivided, and the failure to provide power of authority to the CTCHC to enable the sale
- failure of the City and CTCHC to follow a range of building control procedures which ultimately led to problems in issuing clearance certificates for the transfer of the property to the beneficiaries
- the lapsing of the General Plan in the absence of transfer.

It appears that the issues were finally solved in 2006.

From 2010, after the City disposed of its share in the CTCHC, the CTCHC was required to purchase all property in Legacy Projects and New Projects not yet transferred to buyers, and in the future, buy

[88] Zweig, 2006.

all land it wished to develop outright. It has recently come to light that some of the required transfers from the City to the CTCHC were never completed[89].

New projects

The CTCHC purchased most of the mother erven in the newer projects from the City of Cape Town, taking transfer from the City. No account of the seller's responsibility to ensure that the property being sold in instalments is registrable is given in the sample contracts, but it does seem that the property is registrable, as no associated transfer problems have been reported.

3.6 Other important factors

Rates and water payments

The CTCHC have reported fundamental differences between itself and the City regarding who is liable for collecting and paying property rates and water service (and sanitation) charge payments[90]. The City bills the CTCHC for the property rates and water consumed on the property and not the individual buyers.

All the ISA sample agreements clearly indicate that the buyer is responsible for paying municipal service charges and property rates, which is in line with the ALA. It is on this basis that the CTCHC argues that the City should bill buyers individually. While the Legacy Project agreement provides for the inclusion of the property rate payment as part of monthly instalments, there is no such measure in the agreements for the new projects. The CTCHC has given the buyers the responsibility for paying these fees directly to the City.

CTCHC has also argued that it is a Social Housing Institution and should thus be exempt from Property Rates (i.e. given a rebate of 100%). We have not tested this claim with the City. A former official reported that the City actually did apply the policy of 100% rebate to the CTCHC. The process seems to entail applying to the City for the rebate at the end of each year.

The City, on the other hand, expects the CTCHC to recover the rates and charges from residents. It seems that tax amounts are determined on the value of mother erven owned by the CTCHC and water charges are determined on the basis of usage/volume of consumption. It appears that this arrangement has always been disputed and the CTCHC has not attempted to recover the fees from individual beneficiaries. According to the former official, these property rates arrears have largely been written off, at least until recently. Presumably, rates clearance for the transfer of individual beneficiary properties is not an issue, as the account is with the CTCHC and not individual beneficiaries.

Transferring property to deceased estates

Calls to the Department for assistance from a buyer of a unit in a CTCHC development (i.e. Phillippi) made to the Department have brought attention to another negative consequence arising from the property rates payment arrangement instituted by the City as described above. Because the City does not collect rates on the individual properties within the CTCHC developments, it does not conduct valuations of the individual properties and thus does not place the property on the municipal valuation roll. The lack of valuation means that the Master of the High Court cannot use

[89] See point 3.6 at the end of this case study write-up.

[90] Electricity is prepaid by consumers. Refuse removal charges have not arisen in the interviews but are also likely to be an issue.

its usual method for determining the value of the property within the estate, i.e. the municipal property valuation, and therefore cannot appoint an executor. CTCHC requires the appointment of an executor or the issuing of a letter of authority to transfer the property to the deceased estate. Even if the CTCHC did transfer the property to the deceased estate, without an executor or letter of authority, the property is essentially frozen within the estate. The City has indicated that it cannot value the property without the transfer of the property to a buyer; therefore, the heirs of the deceased cannot access the property. It seems that other measures will need to be found to provide the Master with the value of the property, but the parties involved appear to have no way of coordinating amongst themselves to find a workable solution.

In investigating the query, the City was found to still own the land in at least one of the Legacy Projects, despite attempts to transfer all remaining City land in the CTCHC developments to the CTCHC.

4.3 Privately funded instalment sales

4.3.1 Chartwell housing finance solutions[91]

1. Summary details of setup

According to their website, “Chartwell is an integrated residential real estate investor and home loan provider to our qualifying customers, especially first time and upwardly mobile aspirant home-owners”.

The Chartwell Group was established in 2008 and started out in two areas of business:

- **Instalment sales management and administration provider:** Managing of instalment sales schemes for property developers (such as employers), often referred to in short as “staff housing schemes”, in which the developers retain ownership of the scheme and Chartwell recruits buyers (from staff), administers the loan scheme, including the collection of payments and manages the property for the owner, often funded by levies etc. collected as part of the instalment payment.
- **Consumer education provider:** The development and delivery of training materials and services on an agency basis for a host of institutional clients.

From 2016, Chartwell has opened a third area of business, Chartwell Housing Finance Solutions (Chartwell):

- **Property investor and loan provider:** Over the last three to four years, Chartwell has begun to invest in property, through purchase and on-selling. Chartwell is centrally involved in the planning and conceptualisation of projects, identifying the site/land for development, the market split and housing typology for the site, as well as the unit specifications/standards. Chartwell works through third-party developers who purchase the land and finance and construct the development. Chartwell arranges to buy units built in target developments if the units meet pre-established quality and design requirements and provides security to developers in the form of a bank guarantee.[92] Chartwell sells the individual properties in the development via outright purchase or through instalment sales to buyers. With instalment sales, by definition, Chartwell is the seller and the loan provider.

Chartwell’s investment and loan activities are funded by loans from a single funder, an international pension fund. Funds are made available for investment upfront, based on signed feasibility reports and not raised against the development i.e. not secured through a mortgage. Chartwell uses the funds to purchase units in the privately developed housing projects (see below). Once units have been sold to end users (either in an outright sale or via instalment agreements) and, in the case of instalment sales, buyers have taken occupation, Chartwell will start paying off the debt. Debt repayment will be via proceeds from the instalment payments. Operations and maintenance of the developments are funded by additional payments referred to as recoverable amounts.

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[91] Paul McHardy, Executive Manager, Chartwell Housing Finance Solution, provided all the information for this case study.

[92] “The bank guarantee means a lending institution ensures that the liabilities of a debtor will be met. In other words, if the debtor fails to settle a debt, the bank will cover it”. https://www.investopedia.com/terms/b/bankguarantee.asp

Chartwell buys new units for resale in two types of development scenarios: First, in projects which it helps conceptualise and in which it has commissioned units of the development. Units are bought in bulk at the discounted prices. Chartwell started these purchases in 2016. Second, in developments in which the developer cannot find mortgaged financed buyers. In such projects, the developer or its agents will pass potential buyers onto Chartwell. Chartwell buys the unit and resells it to the buyer on instalment. Chartwell started investing in terms of this scenario in late 2019. In both types of development, Chartwell takes transfer of the units and recovers the costs associated with transfer in the price of the unit.

Chartwell is a member of the South African Credit and Risk Reporting Association (previously known as the Credit Providers Association) and its Emerging Market Home Loan Fund is registered with the National Credit regulator[93].

2. Summary of outcomes

In terms of scenario 1 (defined above in 1), Chartwell has invested in 3 000 properties since 2016. At the outset, prices ranged between R400 000 and R1m, but the current batch of properties range from R520 000 to about R1.2m. In terms of scenario 2, Chartwell has bought units in two developments, both in Gauteng Province: Olivienhoudtbosch, where unit selling prices range between R750 000 and R1.1m and Watervalspruit, where units range between R850 000 to R1.2m. The funder's requirement is that 75% of the number of units developed is priced at R700 000 or below.

The default rate on instalment sales is currently is 0.5%. These defaults only cover sales in which Chartwell, as the seller, has cancelled the instalment sales agreement. Excluded from the 0.5% are buyer cancellations and the outright sales to a third party. According to Chartwell, the agreement states that the buyer cancellations are only possible if the buyer can pay up on the remaining debt via their own funds or via a mortgage.

3. Factors impacting outcomes

3.1 Selection of buyers

Chartwell has developed quite an extensive applicant or client screening process over the years of its existence. The process screens for propensity to pay and for affordability. Chartwell requires that funders mutually agree on a credit "scorecard". Chartwell did not divulge how the balance in their own investment projects is set.

Propensity to pay is taken from credit scores produced by credit bureaus, with funders determining the threshold they are willing to tolerate given their appetite for risk. More than one credit bureau is used to check the credit record and to improve comprehensiveness of the assessment.

The affordability assessment is aimed at assessing whether the applicant's household can afford the monthly payments of instalments and recoverable expenses. Although norms for share-of-income ratios for accommodation are taken into consideration when assessing households, detailed household budgetary assessments are undertaken to check affordability for lower-income households. Applicant households need to submit pay slips and bank statements to Chartwell for analysis, with further information on household budget collected through interviews. The aim of the assessments is to determine the ability of the household to absorb expenditure shocks and maintain

93 Chartwell website https://chartwellgroup.co.za/

housing related spending, i.e. to check whether there is leeway in their monthly budgets for spending shocks which include interest rate increases. Bank statements are considered, with some detail collected for cash withdrawals: are such withdrawals for non-discretionary spending commitment (such as loan repayments)? Where are typical monthly commitments found in the bank statement, e.g. transport/commuting costs, school fees etc and what do they amount to?

Consumer education: Chartwell's Consumer Education programme has also been developed over time and is built into the selection process. The education and testing programmes are delivered on-line and are heavily visual. Training takes place between application for the instalment loan (i.e. the process in which the applicant agrees to be considered and vetted) and the signing of the instalment sales agreement.

Regarding content, the training starts with the rights that are created for the parties in the instalment sales agreement and how the parties can exit from the agreement. The training also considers how interest payments can be decreased over the course of the loan by increasing the instalment payment every year above what is required in the instalment sales agreement – for example, by increasing payments by R100 per month every year. The implications of the sectional title tenure arrangement are also explained, especially the difference between private and communal or common space and different levels of responsibility in maintaining each realm, i.e. individual for the private space and group for the communal spaces. The importance of levies and the smooth running of the body corporate in order to maintain the capital value of units in the scheme is stressed. The vulnerability of the body corporate and the resulting downward spiral of non-payment ("domino effect") of the scheme, and thus the danger of even small amounts of non-payment, is also explained.

3.2 Affordability

Chartwell structures its instalment sales loans like mortgages. Maturity periods are 20 years and instalments are fixed at a constant level throughout the loan period, except where interest rates are adjusted due to changes in the REPO rate, in which case instalment payments are increased or decreased to maintain the rate at which is capital on the original loan is paid down. Interest rates on average amount to prime plus one but may vary up or down based on assessed risk.

Over the course of the loan, as the capital owing decreases and the amount in the instalment spent on interest decreases, the amount spent on paying down the capital increases at an ever-increasing rate. The fixed nominal payments (without automatic rate-related changes) in the presence of increasing household income, even if the increases are only at the rate of CPI increases, are likely to become more affordable for the household over time and present an opportunity for the household to lower maturity periods and reduce gross interest payments by voluntarily increasing monthly instalments every year. As mentioned above, Chartwell encourages the latter behaviour through its consumer education programme. Buyers are encouraged to increase payments by R100 per month every year.

Initial transfer costs, that normally form part of upfront payments in an outright sale, are explicitly charged as a separate payment (see section 3.5 below). These are included in the selling price, but in the bulk-buy scenario where Chartwell takes simultaneous transfer of the units, the company is able to negotiate a discounted price with conveyances and pass this discounted price onto buyers. Chartwell's funder does not secure its finance by registering mortgages against the properties being sold in instalments, and therefore no bond registration fees are incurred by any party. The buyers are required to cover the transfer fees at the point where they take outright ownership of the units.

The payment of VAT is also a key cost factor in the selling price. Chartwell charges its buyers output VAT on the sum of the price charged by the contractors for the unit and Chartwell's mark-up and pays over the VAT proceeds to SARS. The sales price for the buyers includes VAT, but instead of paying over the VAT in one lump sum to Chartwell as would occur in an outright sale for payment to SARS, the amount is paid off by buyers monthly based on the amount of capital paid off every month i.e. the VAT rate (i.e. 0.15 X the amount of capital paid off). According to Chartwell, the instalment sale method and payment of VAT in instalments allows for Chartwell to reduce the interest-bearing debt it must take on to pay SARS in a lump sum and can theoretically pass these savings on to buyers in the form of reduced interest rates, although it can also simply retain its mark-up on interest rates. The savings arise because the present value of VAT payments instalment is substantially less than a lumpsum payment made in the present.

The lowest income households that Chartwell has reportedly targeted for its investment projects is R14 600 (i.e. R7 300 per adult in a two-adult/two-income household), although it seems that the income threshold has shifted up since then.

Starting prices for units vary per development and currently the lowest cost unit on offer is about R530 000. Developments are restricted to Johannesburg, Cape Town and Durban. A mortgage loan of R530 000, with an interest of rate of 11% (which is prime + 2%), is currently affordable to households with a household income of R18 235. Affordability thus seems to have been eroded by construction inflation, although remaining within the FLISP gap market income brackets. However, this calculation does not take account of recoverable amounts and insurance payments (see below), which will lower affordability and drive it further to the top of the FLISP income bracket.

In addition to instalments to repay the loan (which consist of repayments for the capital and interest), several recoverable amounts are also charged and require payment.

The two types of recoverable amounts are described in Table 4 below.

Table 4: Recoverable amounts in Chartwell investment projects

Type/name	Typical amounts at present	Description of what is covered in payments
Levies	R600 to R1000	• Sectional title levies
Other recoverable amounts	R600 to R1000	• Rates and water • Additional services chosen by the body corporate of the development including extra security (boom/access control), landscaping etc

Chartwell also requires that the buyers take out life insurance in addition to the above. Chartwell offers a product provided through a group scheme, which means that costs are usually below average for buyers. The product provides cover for inter alia retrenchment and will pay out full instalments and levies recoverable amounts for 12 months.

3.3 Building quality

Chartwell has measures to ensure that the units built in target construction projects comply with the specifications they defined while remaining within budget in the construction process. Third-party developers take significant risk for the development of the project according to specifications laid out by Chartwell. A third-party developer might already have land and development planned or purchases the land specified by Chartwell and finances and implements the whole development process, including the township establishment and sectionalisation processes, so that all units are ready for transfer when the sale process is initiated.

Units are developed in groups of 40 and Chartwell only pays on completion of agreed units, providing a bank guarantee as assurance that payment will be forthcoming for units delivered to agreed specification. Chartwell can omit incomplete units that do not meet the specifications from payment, if specifications are not met. Chartwell has contracted engineers or site supervisors (good building practice per NHBRC standards) on site during construction process to ensure that building occurs to the necessary standard and that the specifications of the contract and NHBRC are met, by agreement with the developer. Chartwell's professionals give the developer ongoing feedback on quality to avoid having to withhold payment as far as possible.

In pre-existing new developments, Chartwell will only purchase units for resale by instalment that meet its specifications and quality requirements.

3.4 Agreements

Chartwell's instalment sales agreement (ISA) is proprietary and was not made available for analysis. Reportedly, they comply with the ALA requirements. This means that the contract will provide information about the nature of monthly instalments and break it down into capital and interest payments per instalment, as well as other monthly charges. The rights and procedures of parties in the case of contractual breaches are also explained.

As part of the agreement, buyers receive quarterly statements indicating payments to date and the capital amount owing. These statements are audited, and the buyer can query their accuracy by first approaching the credit managers and then referring the matter to the ombudsman-linked Consumer Protection Act or the NCA.

Exit from the contract and dealing with shocks

Exit is also relatively affordable, as there are no de-registration fees etc. Ease of exit is also a key way in which sellers can manage the risk of non-payment and non-payment contagion risks.

Chartwell has put in place a mechanism to ease voluntary exit. The buyer can initiate a sale to a third party at any time[94], provided the sale covers the arrears and the amount owing on the property, and the seller will administer the sale on behalf of the current buyer. Any amount generated above the capital still owing and arrears is for the buyer, including any gains in capital

[94] Chartwell also indicated that the exit of the agreement by a current buyer can be facilitated via an agreement with another instalment buyer. The capital gains would need to be paid to the first instalment buyer by the seller. These arrangements have been put in place both in developments where Chartwell is the administrator and the seller (owner) is a third party (e.g. a mining company providing employee housing) and in cases where Chartwell is the investor. In the latter, Chartwell will have to pay any net capital gains to the former buyer.

above the original selling price. Because the "recoverable amounts" that form part of the monthly instalments cover property rates payment and any municipal services, it means that these accounts will be more or less up to date should exit be required, and will not pose a barrier to exit as they often do (i.e. the absence of a rate clearance certificate can pose a significant threat to purchase by a third party).

In an involuntary exit, the seller cancels the agreement without compensation to the buyer. This can only occur if the arrears build up to such an extent that the capital redeemed by the buyer is insufficient to cover the arrears.

3.5 Registrability

In both of Chartwell's property investment scenarios, the developer of the property is responsible for making the property registrable, and Chartwell will only purchase registrable property for on-selling via instalment sales. In the bulk-buy scenario, the developer draws up the sectional plan and registers the plan with the Deeds Office. The cost incurred by the developer for sectionalisation is included in the bulk price charged to Chartwell. Chartwell then takes simultaneous transfer of the units and can negotiate a discounted per-unit price with the conveyancers. A similar arrangement occurs in the individual sales scenario, except that Chartwell takes transfer of the units on an individual basis.

3.6 Other important factors

Sectional title arrangements

As the outright owner of the units, Chartwell grants all instalment buyers full membership of the body corporate, with full voting powers. Prior to the latter arrangement, Chartwell tried an approach in which body corporate membership was given to instalment buyers, but Chartwell still maintained control via the chair of the body corporate. The exact details of how this worked are not available, but Chartwell abandoned this approach in the early stages of its investment projects.

Chartwell does get feedback from managing agents, regarding operation of scheme and the collection of sectional title levies, which are part of the recoverable amounts. Chartwell includes training on sectional title and related governance and financial administrative requirements as part of its pre-sale's consumer education programme. The management agent is also responsible for providing detailed support and advice to the body corporate and the board of trustees. Over the last two years, Chartwell has applied the above approach in the schemes it owns and those it administers without any trouble.

4.3.2 Sentinel Homes[95]

1. Summary details of setup

Sentinel Homes (hereafter referred to as Sentinel) is a subsidiary of Combined Finance Holdings (Pty) Ltd, established in 2012. The housing finance division of Combined Finance felt that the mortgage segment did not have enough market penetration, therefore Sentinel was set up to assist potential buyers who could either not get mortgage loans at all or mortgage loans with unfavourable terms from the banks/financial institutions. Sentinel market themselves as an alternative home financier to banks and other mortgage loan providers. The company obtains funding from a financial institution in order to fund the purchase of a home the client has identified, and then resells the home to the client on an instalment basis. Currently, they operate in the Western Cape and Gauteng only, citing that these two provinces combined are responsible for the majority of the value of the property market in South Africa (and where the estate agents and bond originators must also be located). The first open market instalment sales though Sentinel were approved around March 2018 and the first Deeds office registrations were completed by the end of October 2018.

Most of the applications for instalment home finance sales come from bond originators. Both new and older properties are financed through Sentinel; however, they have not yet funded new properties sold by developers. Only properties that are registerable will be financed. Sentinel's stated aim is to make the process for the buyer as similar to buying a house with a mortgage loan as possible. The individual needs to find a house they will be able to afford and sign an offer to purchase. If the offer is accepted by the seller, the buyer can apply for a mortgage loan from the banks/other mortgage loan providers. If they do not qualify for the required mortgage loan, or if they are Sentinel's target market, their mortgage broker or estate agent can send their application to Sentinel Homes. If approved, the process continues to the point where the buyer moves into their new house and the instalment sale contract is recorded against the title deed of the property in the Deeds office. The buyer then makes monthly payments to Sentinel Homes. While the buyer's name appears on the title deed as a holder of rights over the property (through the section 20 endorsement on the title deed), Sentinel remains the legally registered owner until the final instalment has been paid by the buyer and transfer to the buyer has occurred.

Finance is secured through the large South African banks. Sentinel grants a continuing covering mortgage bond (CCMB) to the bank for each individual property, and the CCMBs taken together form part of the security Sentinel gives to its funders for the facilities they provide. The CCMB is registered in the Deeds office against the property's title deed and remains registered as such until it is cancelled and Sentinel transfers legal ownership of the property to the instalment sale buyer. The bond registration fee is paid by Sentinel (see point 3.4 below on Agreements). The registration of the CCMB is in favour of the bank and ownership is transferred to Sentinel. Sentinel then causes the title deed of the property to be endorsed in favour of the buyer in accordance with section 20 of the ALA.

2. Summary of outcomes

95 Renier Kriek, the Managing Director of Combined Finance Holding which owns Sentinel Homes, provided all the information for this case study.

The value as at February 2020 of the Sentinel book was in excess of R100 million approved loans[96]. This included 32 properties registered in the name of Sentinel with section 20 ALA endorsements either registered or pending and a further 60 properties pending registration of transfer to Sentinel. The average worth of a property on the book is currently approximately R1.47 million. Sentinel aims for a projected return on assets of 1.5% per annum.

3. Factors impacting performance

3.1 Selection of buyers

A prospective buyer should have a good credit record, without judgments or adverse accounts. Sentinel runs credit checks on all buyers, as they are a registered credit provider and are therefore required to do so by the NCA. No consumer education is currently provided by Sentinel, as they are not servicing the lower-income segment of the market yet and their buyers are relatively well-educated. Most of the buyers are referred by bond originators, who do provide market and product education, and Sentinel provides seminars and *ad hoc* counselling to bond originators, estate agents and prospective clients as and when required.

3.2 Affordability

Sentinel requires that the market value of the residential property to be purchased must not be below R400 000, so that the ratio of the transaction cost of the property to the sales price of the unit is not too high. Total finance granted must not exceed R2.9 million. In addition, there is a cash deposit requirement (at least 5% of the value of the property) and a mark-up to cover various costs. The mark-up is calculated such that the consumer pays the same amount in transaction costs as they would have paid if they had been financed with a mortgage loan. Consequently, with the current minimum price restriction and up-front payment, Sentinel reports that it's proposition only appears to be affordable from the middle to upper end of the gap market and upwards.

Sentinel's credit agreements are subject to section 8(4)(f) of the NCA which covers the catch-all category of "other" credit agreements.

The value of the loan that Sentinel gives the buyer cannot exceed the amount paid for the property, as per Sentinel's own mandate. However, the NCA prohibits including transaction costs associated with acquiring the good for which credit has been granted into the loan, except in the case of a mortgage loan. Therefore, in order to recoup their transaction costs in purchasing the property for on-sale, Sentinel charges a mark-up that the buyer must pay up-front. This mark-up consists of the types of expenses that would usually form part of a mortgage-financed transaction, including transfer fees and transfer duty, a bond registration fee and an initiation fee (R1207.75). A minimum deposit of 5% of the purchase price is also required. Therefore, the amount the buyer pays up-front is essentially the same as what they would pay if they received a 95% mortgage loan from a bank. This is paid upfront to Sentinel by the buyer in cash on the date of registration of the instalment sales agreement (ISA) in the Deeds Office (through ALA section 20 endorsement).

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[96] Renier Kriek, Managing Director, Combined Finance Holdings, personal communication, February 2020.

Besides the monthly instalments covering capital repayments and interest charges, Sentinel also requires other monthly expenditure of its buyers. Sentinel requires that the buyer takes out long-term insurance, such as life cover and income or capital disability cover, and home-owner's insurance to cover the property against the customary perils. Sentinel approaches brokers for quotes which they pass on to the buyer (along with a letter stating the insurance requirements), but buyers are encouraged to source their own insurance. Long-term and short-term policies are ceded to Sentinel so that they can ensure the premiums are paid and so that they are notified of any claims. There is also a monthly administration fee of R69 as prescribed by the NCA.

Affordability is determined according to regulation 23 and regulation 23A of the regulations to the NCA. Checking loan applicant affordability is performed by Sentinel, i.e. it is not outsourced. When checking the affordability of the monthly instalments for a particular buyer, Sentinel checks bank statements for income and expenses and validates expenses against the applicants' credit records to determine income available for housing. Before the home loan is granted, Sentinel also applies the minimum expense norms for the client's living expenses to check whether the applicant can afford the extra expense of servicing a home loan,

Sentinel maintains that they provide finance at similar interest rates to mortgages. Interest rates fall between prime plus 0.5 percentage points and prime plus 1.5 percentage points. This is apparently comparable to similar finance offered from mortgage loan providers in the target market, which consists of non-salaried or only partially salaried applicants, foreigners, contract workers, freelancers and similar.

3.3 Building Quality

Because Sentinel is legally the seller of the property to the buyer, they are obliged by the CPA to provide a guarantee against defects. In terms of section 56(1) of the CPA, any transaction or agreement is subject to an implied warranty by the producer, retailer or supplier. Thus, the property Sentinel is selling to the buyer needs to comply with quality requirements and standards, i.e. it must be free from any defects and fit for purpose. However, the implied warranty is not applicable if the buyer was informed of the specific condition of the property and still accepted it. Thus, Sentinel maintains it mitigates its risk by having the buyer confirm in writing that the property being financed is the one they identified themselves and that it is in good condition (warrant of fitness for purpose). Whether this arrangement completely absolves Sentinel of a broad-ranging implied warranty is unlikely and remains to be tested in court.

Sentinel (through their outsourced valuations provider which is fully accredited and for which they pay) also compares the municipality-approved building plans for the property to the actual property to check that they correspond. Furthermore, Sentinel requires that the purchasers confirm that the building plans correspond to the property as viewed. They also check whether the seller has been issued with an occupancy certificate from the municipality (for new properties younger than five years) and whether the NHBRC warranty on structural defects is still valid (only valid for five years). The valuations provider also conducts a formal valuation of the property for Sentinel. As part of Sentinel's arrangement with the bank, the bank is given access to the valuation before it extends its funding facility to Sentinel and places a mortgage on the property.

The buyer is expected to look after and take care of their house as they would be with bond finance.

3.4 Agreements

The instalment sale finance differs from traditional mortgage finance in that the property must be used as a primary residence by the buyer, unless they obtain consent from Sentinel to rent it out. Such consent will likely be granted in all instances, and specifically where reasonably required, but buyers will have to comply with Sentinel's conditions. Such conditions will be aimed at ensuring compliance with the Rental Housing Act and limiting risk associated with having a tenant if a foreclosure is required in future.

Sentinel uses a somewhat unorthodox structure for its instalment loans. Although its loans follow a 20-year maturity amortisation structure with interest rates that are very like those of mortgages, the loans have a 10-year maturity with options to renew the term after expiry of the initial 10-year period. If the buyer wants to extend the contract beyond 120 months, they are asked to supply their latest payslips and are given a new financing deal. It is likely that at this 120-month point the buyer will have paid off less than 25% of the capital – most of the monthly instalment payments would have gone to paying off the interest of the loan – as is standard with non-straight-line amortisation also used for mortgages. The minimum instalment amount in the subsequent agreement may be less than the initial agreement, due to there being less capital to pay off, but buyers will be able to retain the instalment values from the first loan period, so that more capital is paid down every month than the minimum amount in the new instalment. The structure reportedly allows for better alignment in the maturities between Sentinel's loan offering and the finance it has available from banks to fund these offerings and reduces the amount of liquidity risk faced by Sentinel, which serves to bolster its balance sheet and its resilience and which is also in the interest of borrowers. The impact of this arrangement on interest payments over the life of the loan requires further investigation and would depend on how interest rates change between loans and the size of penalties for accelerating payments. Currently the only charges provided for in the NCA section 125(2)a-c are for early termination of a credit agreement if less than three-months' notice is given by the buyer. The penalty is capped at the interest payment that would have been charged in the minimum notice period shortfall. Prepayment can occur without notice or penalty.

As per the ALA and the agreement Sentinel has with the buyer, the bills for rates and services are the responsibility of the buyer. This is identical to mortgage-financed properties. However, given the relative novelty of the offering, most municipalities insist on billing Sentinel directly for rates, which Sentinel then has to recover from the buyer.

Sentinel is a VAT vendor for the purposes of selling residential property, which is a Vatable supply, and consequently output VAT is recovered and paid over to the Revenue Service as required by the VAT Act. The sales price of the property is quoted as an inclusive of VAT figure in all contracts and client facing documents. Therefore, VAT is not paid separately by the buyer. Sentinel contends that they account for the input and the output VAT, which are nearly equal, according to the normal rules of VAT. Thus, the VAT is a nearly zero-sum exercise (output VAT being very slightly more than input VAT).

Buyers can opt out of the agreement with Sentinel at any point by paying the outstanding amount of the loan, as per the ALA and NCA. Section 125 of the NCA permits the buyer to settle the outstanding amount of a loan agreement at any time. Section 17 (c) and 15 (1)(f) of the ALA provides the buyer with similar powers. These sections do not distinguish between different sources of funding for settlement, i.e. between a buyer simply paying Sentinel what is still owed, and a buyer selling the house to a third party to generate the funding. Therefore, according to Sentinels reading, buyers are free to sell their house at any time before the finance is repaid on the proviso that the selling price covers the outstanding debt with Sentinel and, as specified in its ISA, that Sentinel can be guaranteed that the funding is secured. The buyer does not need Sentinel's consent to sell the house, except if the selling price for the property does not cover the outstanding amount owed to Sentinel. According to section 28 of the ALA, as the seller, Sentinel is entitled to recover "reasonable compensation" for buyer's occupation of the property and any damages to the property. Section 28 also provides for both parties to recover their relative "performance"[97] in terms of the contract upon sale prior the full repayment of the instalment sale loan. Thus, the sales price of the house needs to cover what Sentinel is owed in terms of the capital/principal debt, arrears and interest on arrears and payment of expenses. The sales price must also cover the estate agent's fee, if any. Any remaining capital gains resulting from the sale go to the buyer. Sentinel therefore does not benefit from the equity accruing on the property over time, save for the obvious (though indirect) benefit of the increased security value of the property.

In the case of the buyer selling to a third party before the instalment sale is complete, the contract between the buyer and Sentinel states: "Upon final settlement of the principal debt, or against tender of such final settlement supported by an acceptable bank guarantee payable at Sentinel Homes' order and subject only to transfer of the Property to the Purchaser, Sentinel Homes will ensure transfer of the Property to the Purchaser by conveyancers appointed by Sentinel Homes, the costs of which transfer will be for Sentinel Homes' account." Transfer is simultaneous from Sentinel to the buyer and then from the buyer to the third party, with Sentinel paying for the transfer to the buyer, and the third party paying for the transfer from the buyer to them. Sentinel will only make the first transfer to the buyer if it finds the bank guarantee from the third-party buyer acceptable.

The contract with the buyer states that in the case of non-payment, Sentinel has the right to sell the house. The buyer will be allowed to continue living in the house while it is on the market, so long as they co-operate with Sentinel in the selling of the property, i.e. does not try to block the sale and grant reasonable access to the estate agent for viewings and show days. The "payment waterfall" on realisation of a sale from the marketing process follows the same order of priority as in the case of a buyer deciding to sell the house (and thereby cancelling the agreement). Sentinel has thus far avoided taking buyers to court and prefers to work with them, to avoid the risk of a buyer receiving a judgement against them that will negatively impact their credit rating.

Besides the regulations ordinarily covering housing finance in South Africa, instalment sales are also covered under the ALA. Sentinel reportedly abides by the Act's provisions. This means that buyers are extended various protections against mortgage providers with liens on the property being sold and against the seller's creditors seeking to attach property for sales in execution. The measures in the ALA are explained in some detail in section 3. Sentinel has pointed out that the Insolvency Act provides a strong incentive for the liquidator to carry on the business of the insolvent company to recover continued payment of instalments rather than through the sale of assets. The Insolvency Act provisions are also explained in Chapter 3. Sentinel points out on its website that it is highly likely that a former buyer will be allowed to remain in their homes so long as they continue to abide by the terms of the original loan agreement and continue to pay the monthly instalments to the financial institution that gave the loan to Sentinel initially.

3.5 Other

[97] "In a contract, performance is deemed to be the fulfilment of an obligation, in a manner that releases the performer from all liabilities under the contract." http://www.businessdictionary.com/definition/performance.html

Sentinel does not finance the purchase of vacant land, farms and small holdings, a condition stipulated by the financial institutions from which they receive the loans.

When financing the purchase of a property in a sectional title scheme, Sentinel accesses the most recent AGM minutes and financial statements of the body corporate to check on the health of the scheme and that the investment is safe. This is a further manifestation of the fact that Sentinel's incentives are, by virtue of the legislative position, more closely aligned with those of the housing consumer than would have been the case in a mortgage-financed acquisition. In other words, in terms of the CPA, Sentinel is obliged to supply goods that are fit for purpose and therefore need to do the "extra" work, over and above what a bank would do in the case of providing a mortgage, of checking that the body corporate functions properly.

4.4 Government subsidised lease options

4.4.1 Social Housing Company (SOHCO) Amalinda Village Project[98]

1. Summary details of the setup

In 2000 the SOHCO started to develop the Amalinda Village Project in East London. The project is still active with the deferred ownership component almost complete. The project is well located, close to economic and social opportunities and proximity to the CBD of East London, in a lower middle-class area with property prices that have escalated in real terms.

A lease option model has been used with a minimum lease period of four years, in line with the Institutional Subsidy. The aim of the scheme was to provide sectionalised one- and two-bedroom units in three-storey walk-up blocks of 12 units each. The original target was for 500 lease option units.

The units were to be financed through a mix of Institutional Subsidies, donations and the concessionary finance accessed through the NHFC. It appears that hidden subsidies were kept to a minimum. Details about the cost of the land are not readily available. The land was bought from the municipality through a tender process. Developer charges were not levied, but in keeping with practice in the municipality at the time, SOHCO may have funded the upgrade of infrastructure required to service the development.

When the project started, actual individual unit development costs ranged between R85 000 and R65 000. The Institutional Subsidy at the time was R18 400 per unit, while the donation, from the Flemish Government, was R11 000 per unit. The balance was loan-financed. Selling prices were thus to lie between R55 000 and R35 000 per unit or between 65% and 54% of the actual cost of the unit.

Rents and proceeds of the sale were to service the NHFC loan, which was drawn down during construction on proven cost basis and converted into a 20-year loan on project completion. Rent was used for interest and operations only. Only the proceeds of the sale were used to pay off the capital owing. SOHCO has indicated that the allocation of collections to cost items was kept simple to handle rental arrears in a way that was simple and transparent to buyers and to keep rentals as low as possible. As interest rates went down, SOHCO allocated more of the rental to cover operational costs, which meant that rental increases could be kept low. Rents were only adjusted once per year.

2. Summary of outcomes

The scheme evolved in ways that were not envisaged at the outset. In the end only 224 units were produced for lease option (from an original target of 500 units), and these were embedded within 374 long-term rental units. One of the reported reasons of this evolution, is for SOHCO to retain control of the body corporates in each of the sections. But there are likely other reasons related to the need to retain administrative economies of scale in the scheme, even as lease option units were transferred to beneficiary tenants.

[98] Heather Maxwell, the CEO of the SOHCO group, provided all the information for this case study.

The first part of the scheme was built between 2000 and 2003 (408 units) and made use of the Institutional Subsidy and donation and the second part in 2005 and 2006, which was totally loan-financed (no subsidies and donations were available) and had a higher cost structure due to construction inflation. Almost all the units which were sold via lease option, were taken up in the first five handover phases of the development. These were built as one rolling contract between October 2001 and March 2003. The constant pricing over this period was worked into the project feasibility, as it was essentially one implementation project. By the end of the second phase, lease option units were distributed across both phases, which required the conversion of some former lease option units in the first phase into rental units (enabled by cancellation of the lease option agreements). A few Institutional Subsidies had to be paid back, as more units were subsidised than units ending up in becoming available for lease option.

Buyers bought in in two waves, corresponding to the two construction phases, with first transfers occurring in 2007, six years after the construction of the first phase. To date only two out of the 224 lease option units has yet to be transferred. Lease option payment rates in the leasing stage were around 98% for most of the leasing period, although in the initial stage in 2003, collection rates touched lows of 70%. By the end of 2003 the rates were close to 100%.

3. Factors impacting performance

3.1 Selection of beneficiaries

Over the years, SOHCO has developed a comprehensive approach to screening applicants for its schemes. Both affordability and creditworthiness are considered. Pay slips are reviewed, as well as bank statements of the last three months before application. Credit bureau checks are conducted, and a budgeting exercise is undertaken with applicants to check affordability. Applicants were screened before applications were submitted for Institutional Subsidies.

3.2 Affordability

SOHCO has been at pains to keep rental increases at an affordable level, only increasing rents in line with increases in the income of would-be buyers. Rents were held below market level for the area, although they were linked to the interest rate of the underlying loan, which was a problem, as it led to fluctuations in rent that weren't linked to income.

As mentioned, sale prices for units were constant at between R35 000 and 55 000 between 2001 and 2013, which was the target date eventually set for all purchase options to be taken up or face cancellation. Nearly all the building of units for lease option occurred in the first phase, when building costs and property values were relatively low[99]. Keeping prices constant meant that any capital gains in the property were solely for the benefit of the beneficiaries. Over the last few years, lease option units have been resold for between R350 000 and R450 000, confirming the substantial capital gain, all of which went to the beneficiary.

Over the course of the project, the mortgage requirement was thus held to a moderate level between a typical mortgage for the target market (i.e. below R3 500 household income per month), which were rarely awarded and an unsecured loan. Initially beneficiaries found it difficult to obtain mortgages: banks denied individual applications because they felt the relatively low mortgage

[99] Only 3 to 4 units built in the second phase were for lease option.

amounts did not justify their administrative expenses. Banks also did not appear to understand the relationship between their risk and rewards in these transactions. SOHCO facilitated access to mortgages by communicating with local bank branches and providing information on the numbers of mortgages being sought and thus informing banks of the economies of scale that were possible.

Monthly mortgage instalment payments turned out to be similar levels to the monthly rentals, which also underpinned affordability.

SOHCO has also allowed an extended lease period for the purchase option to be taken up, way beyond the minimum of four years. Extensions of between five and eight years have been granted and even more in cases where SOHCO assessed that would-be buyers were seriously trying to raise finance.

3.3 Building quality

SOHCO have indicated that the quality of build is a key factor in the sustainability of a scheme. To secure payments from tenants and would-be buyers, units need to maintain their integrity over the repayment period. Both renters and buyers need to perceive that they are receiving value for money. Poor quality also makes projects and their beneficiaries susceptible to political manipulation and payment boycotts that tend to become intractable.

By 2003, 408 units had been built, only half of which were occupied and had payment rates of 70%. There had been no sales or transfers as the four-year minimum rental period had not elapsed. The low payment rates were linked to complaints about building quality.

Would-be buyers began to complain about building quality issues, namely some limited water penetration at the floor-wall joints manifesting as damp areas in the units. The problem became quite pronounced because tenants were not airing out the units, which given the high diurnal temperature range, can lead to high levels of condensation inside the units. Although fixing the water penetration was relatively expensive, SOHCO saw addressing the fault as a priority as it provided grounds for non-payment. Fortuitously SOHCO had an architect on its staff and could investigate and find the fault over time. Building contractors were held to the terms of their contracts and approached this issue in good faith; they managed to get the issues resolved.

Lapses in construction quality seems to have been one of the factors behind poor payment rates in the early 2000s, a few years after the start of the project. It seems that fixing the quality was not sufficient and needed to be accompanied by consumer education and other interventions to restore payment.

3.4 Agreements

The lease option agreements were signed with each of the beneficiaries/would-be buyers. The agreements are suspensive sales agreements. Both the lease period and the terms of the sale are included the agreement, including a fixed sales price. Transfer is conditional on receipt of the sales price. There is no need for a separate sales agreement after the rental period is complete.

The four-year lease period could be extended at the request in writing of the beneficiary. SOHCO confirmed extended leases with beneficiary in correspondence. The latest date to which leases were extended was 2013.

Dealing with a break-down in the agreements

SOHCO have indicated that there have been about six lease option agreements that have been highly problematic, where arrears built up without the option to purchase being taken up. The last two cases SOHCO is currently dealing with are illustrative.

- One is a deceased estate, subject to a dispute in which the widow refused to take transfer while the stepdaughter wished to. The dispute has gone on for seven years. SOHCO has decided to transfer to the deceased estate.
- In the other, the buyer left a sub-tenant in the unit and stopped paying rent and would not progress the transaction to a sale. SOHCO took the buyer to court to try to recover the unit. This legal process has taken three years, as she has appealed earlier judgements. SOHCO has progressed the case to the High Court. The buyer has made no payment for over four years and arrears amount to R250 000.

Consumer education and addressing non-payment

In 2003 SOHCO started to work with a "committee of concerned residents" that was formed spontaneously to address the latent defects in construction, which as mentioned, were relatively moderate in nature. The committee allowed SOHCO to communicate clearly with the beneficiaries and to resolve the construction issues. SOHCO also managed to communicate with the committee about the downsides of not paying the rent within a lease option agreement. The committee seemed to realise that a lack of payment would lead to a spiraling deterioration of living conditions in the development and a loss of value of the asset and significantly lower the chance of residents owning a fixed asset of value. SOHCO, aided by the committee, conducted an education campaign aimed at beneficiaries, to demonstrate the high value of the asset in relation to the monthly payments and the sales price of the units.

3.5 Registrability

Sections thus had to be carefully designed. The sectionalisation process was found to be lengthy and it transpired that units were not made registrable within the four-year minimal rental period. Fortuitously, aspirant buyers could not obtain mortgages after the four years and required more time to become credit worthy.

3.6 Other important factors

Sectionalisation and arrangements within the body corporate

SOHCO took a decision early on that the setting up and effective running of body corporates was central to the viability of the project. Part of their mission was to prove viability and these types of projects and funding mechanisms could work to create financial assets for the market of poor households. In addition, the scheme needed to keep on attracting and retaining renters who would turn into buyers, units therefore had to be well maintained and common areas well managed. This commitment to a viable body corporate drove a reconsideration of the mix of buyers and long-term renters in the scheme and the sectionalisation process.

After SOHCO assigned this significance to body corporates, they redesigned the mix of long-term renters and buyers so that SOHCO could retained control of body corporates within the scheme. In cases where SOHCO does not have outright control of the body corporate, it has indicated it has sufficient interest in the body to "anchor the body's functioning". The sectionalisation design was also seen as important to both achieve quorums of a manageable size to allow for good decision making and to make sure that long-term rental units where adequately distributed through the scheme to enable control. According to SOHCO, given the regulated ratios of unit numbers to quorum size, sections of 80 to 100 units are optimal.

The current setup gives SOHCO an outright majority in a number of the body corporates and a significant stake in all, allowing it to influence the setting and collecting of levies and the management of maintenance and the setting and enforcement of rules in the development. As mentioned, it may be difficult for residents to impose levies on themselves and to enforce payment on neighbours and possibly friends etc.

4.4.2 Housing Association of Blaauwberg (HAB)

1. Summary of the setup

The Housing Association of Blaauwberg (HAB) was established in 1999 as an entity of the Municipality of Blaauwberg[100]. Its establishment occurred before amalgamations of all municipalities in Cape Town into one Unicity in 2000. By the time HAB started implementing the project in Wesfleur, Atlantis, it was a separate section 21 company, with a management structure separate from the Municipality. The company was to play the role of developer in the area, including raising finance, managing construction and subdivision, administering agreements with beneficiaries (would-be buyers and tenants) and undertake payment of rates, water and electricity to the municipality, since all the properties having been developed were registered in HAB's name.

The original plan was to build 800 30 sqm houses. The houses were to be sold at R22 000 via a lease option arrangement[101]. The option to purchase could only be exercised after four years, at the price given in the agreement with the buyer, as set out under the Institutional Subsidy.

The company was seeded with a loan from the NHFC and grants of land from the municipality. The first project was started in 2000. HAB was to finance the servicing of the land from the loan and subsidies. The funding sources for HAB as far as we can glean, are summarised in Table 5.

Table 5: Funding sources for HAB project

Item	Value R'000
Land	28 parcels (being 16ha) of unserviced land were earmarked for transfer to HAB at R1 a piece (see red parcels on the map)[102]
Institutional subsidies	11 900[103] to 15 000[104]
NHFC loan	19 100[105] to 22 000[106]

Sources: See footnotes

2. Summary of the outcome

By 2007, 676 houses had been built with some being built on land parcels not yet sold to HAB by the City, in error it seems[107]. At the time land use approvals did not require the registered landowner to submit the application as the process does currently in 2020. Therefore, HAB could obtain approvals

[100] Dentlinger, L. 23 July 2007. *Council 'not liable' for R22m loan*. IOL. https://www.iol.co.za/news/south-africa/council-not-liable-for-r22m-loan-363099

[101] Dentlinger, 2007.

[102] Smook, E. 19 November 2010. City acts to sort out long-standing housing bungle in Atlantis. Cape Argus. https://www.pressreader.com/south-africa/cape-argus/20101119/282638913977951

[103] Unattributed. 10 July 2002. *Hundreds face losing homes after rescue fails*. IOL. https://www.iol.co.za/news/south-africa/hundreds-face-losing-homes-after-rescue-fails-89474

[104] Dentlinger, 2007.

[105] Cleaver, J. 9 February 2010. *National Housing Finance Corporation LTD v Housing Association of Blaauwberg*. Western Cape High Court. Case no 21304/2009.

[106] Smook, 2010.

[107] Cleaver, 2010.

for development on land it did not own. No power of attorney, it appears, accompanied the application either. By 2008, construction projects had effectively stalled as the company was in financial and managerial distress. By 2010, only seven units had been transferred into the names of beneficiary households by HAB[108].

It seems that from the outset there were questions about the running of the company. A forensic audit in 2001 found a R2m overpayment to contractors. By as early as 2002, it seems the company was in financial trouble[109]. Between 2002 and 2003, the NHFC filed for liquidation in the High Court and the company was placed in provisional liquidation. The mayor, however, postponed the liquidation and asked for an investigation. It seemed that at this point further funds were made available to HAB, although it is not clear from what source. These were capital grants-in-aid routed via the municipality valued at R3.3m[110].

The key source of the financial destress was non-payment of rentals by tenants. This was due to an inadequate billing and collection system on the part of the company on the one hand, and the dissatisfaction of beneficiaries on the other[111]. By 2007, arrears for rentals were reported to be R13.5m, this despite eviction proceedings being launched in court in 2005[112], which were ultimately halted. One of the reasons given for the lack of payment was the quality of units built by HAB. The ward councilor for the area at the time called for a rent boycott until the problems were remedied.

Finally, in 2010, the NFHC's request for liquidation was accepted by HAB, which by that point owed the NFHC R20.08m[113] (figures of R21m and 22m are also mentioned in the press). HAB was also in arrears to the City for property rates, amounting to R16m by then[114]. No figures were available for arrears in water consumption.

Liquidation, occurring between 2010 and 2015, was a protracted process since the NHFC was asked to seek a buyer for the bad debt and "assets"[115]. One possible buyer was the Municipality and the NHFC was in favour of such an arrangement, provided it could recover its loans to HAB. There was also a private buyer showing interest. The municipality in turn could not use housing subsidies to buy back properties developed using subsidies in the first place and was not in favour of using capital from the general rates income for the purpose either. In the end, the city proposed to the liquidator that it would waive its rates arrears (i.e. issue rates clearance over the properties) if the properties were transferred back into its name[116]. The NHFC did not pursue this course of action for several years hoping to recover its loan, all the while tenant queries were being referred to both the liquidator and the NHFC. Neither group had the wherewithal to process the queries and the NHFC eventually relented, wrote off its losses, and allowed the City to take title to the properties once again.

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108 Cleaver, 2010.

109 Dentlinger, 2007.

110 Dentlinger, 2007.

111 Jens Kuhn, Manager: Land and forward planning, Human Settlements, City of Cape Town (up until October 2017), personal communication, October 2019.

112 Dentlinger, 2007.

113 Cleaver, 2010.

114 Jens Kuhn, personal communication, October 2019.

115 Jens Kuhn, personal communication, October 2019.

116 Jens Kuhn, personal communication, October 2019.

Immediately upon transfer the City undertook to transfer the built houses to the occupants or beneficiaries. A survey of the state of the land and an audit of the state of the houses themselves was undertaken to prepare for transfer. Approximately 320 units were not included in the survey[117]. The excluded units were mainly on parcels in the east of the site. These parcels to the east were never subdivided.

The land survey found that:

Twenty-eight (28) discrete cadastral entities of land had been "transferred/sold" to HAB (see the red lines on Figure 2).

Figure 2: Map of land parcels for the HAB project

Of these 28:

1. Eight had been a) subdivided b) developed and c) occupied, yet had *not* been "transferred out" (i.e. registered in beneficiaries' names"). Their subdivision resulted in 225 residential erven (blue lines on map); none of which are vacant.
2. Seven had been a) developed and occupied, but still need to be b) subdivided and transferred out to beneficiaries. The product of this subdivision would be 130 erven; none of them being vacant and thus transferrable to the beneficiaries.

Thirteen remain completely vacant.

[117] Cassandra Gabriel, Policy and Research, Human Settlements, City of Cape Town, personal communication, November 2019.

It was also found that as many as 99% of the occupants were those against whose name and ID number the original Institutional Subsidy was made.

Since 2016, the City has been working on normalising the land registration process to transfer the houses to individual households[118]. Part of this normalisation entails resurveying some of the erven since the house-extensions in some cases cross the original erf boundaries. The City has begun this process, which will end in the registration of a formal township. In addition, some remedial work on the physical construction of the houses would also need to be done. The audit of the conditions found two major weaknesses in the original houses built by HAB. First, there is considerable damp in the units since they are single skin walls and not cavity walls, as would be normal building practice. Second, water meters seem to be shared one-to-five between units, thus making billing impossible and wastage very likely. Each house must be directly linked to the reticulation system and metered individually. The City has started the process of correcting this situation.

3. Factors impacting on outcome

3.1 Selection of beneficiaries

To date, no information can be obtained about the selection of beneficiaries for this project.

3.2 Affordability

It appears that no consideration was made in relation to affordability of households when the product was designed and priced.

3.3 Building quality

The HAB project seems to have been beset with similar problems to the CTCHC, although it seems that the HAB problems were more pronounced. For instance, houses were built with a "single skin" and so were very damp on the inside and outside. It seemed that the building process was not subject to oversight by the City's building inspectors, as in many cases the building plans for the houses were neither submitted by the developer nor approved by the City. Neither were occupation certificates provided by the City for the units. Beneficiaries were allowed to move in anyway.

Furthermore, the level of services was developed at a low standard, to save costs. For instance, water meters were provided on a 1:5 ratio to the houses, which meant that water payments were also low from the outset.

3.4 Agreements

To date, we have not been able to trace information on the nature of agreements with beneficiaries, nor how these were enforced.

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[118] Jens Kuhn, personal communication, 2019.

There is some anecdotal information indicating that rental collections were extremely poorly managed. For example, there are reports that rentals were collected manually in a door-to-door fashion, with receipts being entered into a "black book" carried by the rent collector.

3.5 Registrability

It appears that at no point during construction and, indeed, long after construction was completed, was the township establishment process completed. It seems that some level of planning approval was provided, but the general plan was not prepared for all sites, and plots were not surveyed and pegged. The surveyor had started work but was not paid and withdrew from the process.

4.4.3 Amakhaya Ngoku[119]

1. Summary details of the setup

Amakhaya Ngoku (AN) is a section 21 company established in 2007 in the aftermath of a shack fire in the informal settlement of Masiphumelele[120] in Cape Town. A shack fire occurred in October 2006 on a site owned by the City of Cape Town, which was intended for a school, hence the name "School Site" and destroyed the structures in which 400 households[121] lived. AN was established to engage with government to access subsidy funding for a housing project and gain permission to construct the project. It appears that during a number of community meetings it was established that the initiative would aim to accommodate all previous residents on the site through a medium-density development.

The community established a steering committee, which led the engagement with government and decided to apply for the Institutional Housing subsidy. It was this decision, and advice from a local lawyer who was volunteering on the project, that prompted the establishment of the section 21 company and subsequent establishment of a board. The board was nearly exclusively drawn from the affected community. The only Board member not originally from the School Site was Dr Lutz van Dijk, who established a children's home (NGO Hokisa) in the area before the fire in 2001. Van Dijk played a key role in bringing in professional resources (including an architect, lawyer and accountant) to conceptualise the project in detail and put together the project application.

The first task for AN was to run the beneficiary administration process, to establish how many of the affected households qualified for the subsidy. AN facilitated the completion of subsidy application forms and 352 households were approved. The project was thus designed to accommodate 352 households. A professional team was established, with the architect John Shaw and lawyer Ashton Guthrie playing key roles on a largely pro bono basis. Other professionals also contributed on a free or discounted basis.

AN also decided to raise substantial funds from the neighbouring affluent areas and more broadly via donations. Donations were provided by the government-linked organisation from Germany, amongst others. The accountant for the project was approached for reconciled income and expenditure figures. Only the expenditure figures have been provided to date, but with the proviso that some of the later donations have not been included. The income figures have been drawn from project subsidy application documents and from the HSRC report which obtained its information from Dr Van Dijk (see Table 6 below).

[119] The main source of information for this case study was provided by Dr Lutz van Dijk, a prominent member of the Amakhaya Ngoku Board. Dr van Dijk was the key driving force behind the establishment of the project and its implementation.

[120] Masiphumelele is a township in Cape Town, situated between Kommetjie, Capri Village and Noordhoek.

[121] Scheba and Turok, 2018, p46.

Table 6: Cash flow of the project as given in project application documents for AN[122]

Source of funding	Amount R'000
City of Cape Town	
- Community hall	980
- Internal infrastructure	1 400
- Fencing	50
Provincial Government	
- Institutional Subsidy	27 456
Donor grants	
- Donations	17 000
Vat input	
- Vat	7 652
Total	54 538

Source: Project subsidy application documents

The cash flow projection above is given largely by funding source and suggests the project in total was valued at R54.5 m, with the bulk coming from subsidies, including Institutional Subsidies for R27.5m and municipal subsidies of about R2.5m. Dr van Dijk indicated that the donations turned out be significantly higher than R17m. A figure of R24m is mentioned for donations, and includes all the funding for the community hall, which implies that the municipal subsidy turned out to be lower.

The model was that of a lease option, although the unit would be provided for free at the end of the minimum rental period of four years. Units are 40 sqm, have two bedrooms and when constructed, were valued at R120 000[123]. The development was conceptualised as a sectional title development.

Households were not required to make a capital contribution, as the institution did not require loan financing due to the extent of the donations. The rent of R400 per month was used to pay for municipal services and the maintenance of common areas during the rental period. As mentioned below, the rental was also used to finance a rental relief programme for indigent households.

2. Summary of outcomes

The development was planned with the assistance of local architect, John Shaw, to consist of 12 blocks, providing for 352 units. Only a total of eight blocks (232 units) were built in the end.

The first phase of construction started in 2009. By 2011, of the 172 households which had moved into flats, only 30 had paid their rents in full, 31 households were on rent relief and the rest of the households were not making payments.

[122] Cash flow of the projects given in project application documentation.

[123] Scheba and Turok, 2018, p48.

A hall and playground were also built using only private external donor funding on the site. The community facility was built to provide social infrastructure in the area and create a greater mix of uses in the area.

Construction was temporarily halted in 2009 due to protests by households who did not qualify for the project. According to the HSRC report[124], negotiations with the 'non-qualifiers' failed, which prompted the project team to apply to the Cape Town High Court and obtain permission to go forward with the plan and to build the apartment blocks in phases.

Construction was halted in 2013 as a result of continued conflict within the Board, continued protests by non-qualifiers living on the site, rental boycotts and the collapse of the Board. Some Board members felt there was a lack of support from key political figures at the provincial and municipal level over the course of the project for the ending of the rent boycott and it seemed that politicians were endorsing the boycotters. The land set aside for the remaining four blocks has been occupied with informal shacks by residents.

The expenditure figures as at December 2011, when the 232 units built were completed, provided by the accountant, are given below[125].

Donations – Foreign	*R 20 352 742*
Donations – Local	*R 247 874*
Subsidies received	*R 22 741 701*
Total Income	*R 43 342 321*
Project Expenditure	*R 43 491 585*

Despite the different information sources, the predicted cashflow modified by information provided by Dr Van Dijk aligns with the spending figures from the accountant. The subsidy and donation budget were not fully spent, as construction on the remaining 120 units was not started. The remaining individual subsidies approved were not drawn down, and the remaining donation budget of R4m is banked and cannot be spent. The donor funding was ring-fenced for the construction of the flats and cannot be used for any other purpose.

The remaining 120 families who qualified for the project are waiting for the finalisation of the four blocks in the temporary relocation area established during the construction of the project. This temporary relocation area (TRA) was established on private farmland with the consent of the landowner. The site was later acquired by the City of Cape Town and the City has recently constructed 80 new houses on a portion of the property for residents from Masiphumelele (as part of the Phase 4 housing project, planned for more than 15 years and only realised recently).

None of the units have been transferred to beneficiaries and the land remains in municipal ownership. A number of the units are not occupied by original beneficiaries. Units have been rented out or sold informally. Sub-tenancy and informal sales occurred from early on in the process and contributed significantly to the non-payment problem.

[124] Scheba and Turok, 2018.

[125] Dennis Waterhouse, Accountant, Amakhaya Ngoku, personal communication, 29 January 2020.

In **March 2016**, on the initiative of SHRA, a "turnaround strategy for the AN" was proposed. The consultant working for the SHRA indicated that 17 (out of the 232) tenant beneficiaries had met the requirements of the lease contract (i.e. up to date on their rental payments) and thus qualified for transfer in terms of the contract[126]. Transfer was not, however, possible as sectionalisation was incomplete, and the City would not allow clearance for sectionalisation and transfer due to water arrears. It was suggested that the City, as landowner, should play a key role in unblocking the project. According to the plan, the City would evict the non-qualifiers on the site, making way for development, for which they would be the developer, securing the necessary subsidies. The AN Board would not be allowed to drive the new development but were expected to facilitate the transfer process within the existing sectionalised development to original beneficiaries only. The City was expected to write off water arrears and to install individual water meters, although it seems that task would be complicated by the sharing of hot water cylinders across units[127]. The turnaround strategy excluded building the capacity of a body corporate for the sectionalised part of the development and a proposal for the use of the R4m of donor funding.

The AN Board still seems to be in existence, but only one of the original Board members is currently on the Board. The Board was recently able to use the interest earned on the R4m of donations unspent to finance the external painting of the eight blocks currently in existence.

3. Factors impacting performance

3.1 Selection of beneficiaries

The project was conceptualised to only select households from the area affected by the fire; selection criteria were thus restricted to the qualification criteria for the subsidy. This mechanism assumed that the institutional arrangements, including the payment of rent and ultimately levies, was suitable and compatible with the practices of the affected community, as they had a hand in choosing the solution. The rent level of R400 was also agreed upon in consultation with the community, who had deemed the amount affordable, as many were already paying some form of rent to individuals and bodies who were able to exert some control over access to the site. Affordability and credit worthiness checks were thus not undertaken and the pool from which beneficiaries came from was highly restricted.

The Institutional Subsidy model adopted meant that households affected by the fire which did not qualify for the subsidy were excluded from the project. These households refused to vacate the site from the start of the project, perhaps in the hope that they would eventually benefit from the project. This group were reportedly very disruptive during the construction process and were one of the key factors that led to the failure of the project.

The allocation of beneficiaries to units as they were constructed, appears to have also been a flash point. The AN Board attempted to apply a needs-based approach to order the allocation.

Two Board members were reportedly able to use the management power of the Board to subvert the allocation process and bring in non-beneficiaries external to the project to occupy units, either soliciting or accepting bribes. Although the remaining Board members reported these members to the police, no arrests were made, and the incident weakened the Board. The offending Board

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[126] Vengadajellum, G. 2016. Turnaround Strategy and Plan: Amakhaya Ngoku. Report for the Social Housing Regulatory Authority (SHRA). Alcari Consulting Strategic Housing Solutions: Cape Town.

[127] Lutz van Dijk, personal communication, December 2019.

members pushed back with death threats. The charges against those who were reported to the police were ultimately dropped.

3.2 Affordability

The project was designed and financed (via subsidies and donations) specifically to take account of the affordability constraints of beneficiary households. The only payments required of beneficiaries was rental, which was set at a low level. A rent relief scheme, funded via rental collection, was also set up to subsidise beneficiaries who could not afford to pay the rent, subject to proof of lack of affordability. Rental relief was awarded to households that had a very small or no income. In addition, pensioners and those who were disabled or permanently sick could apply. These applications were prepared with the AN office staff and decided on by the Board. Despite these measures, rental payments soon became a problem.

3.3 Building quality

The construction process was managed by the AN professional team, subjected to the normal building control and inspection process run by the municipality. The Provincial Government followed the normal progress payment regime, with payment release subject to progress checking by building inspectors. Building quality was not reported as a problem or reason for non-payment. It seemed that the City's inspectors repeatedly indicated that the quality of building was excellent.

3.4 Agreements

Given the absence of beneficiary capital contributions and the fact that operational contributions were set at modest levels, meeting the agreement would have been relatively straight forward for beneficiaries, at least in the initial stages. Written agreements were put in place and signed by parties.

The Board felt unable to carry out evictions following non-payment, despite the granting of 21 eviction orders by the court upon application. The Board was of the view that enforcing an eviction process would result in violence and a further deterioration in governance within the project. Furthermore, Board members felt they were not provided adequate protection by government officials. A stay was put on the evictions, on condition that an upfront payment of R600 was made to address some of the rental arrears. While beneficiaries paid the R600, they continued to default in the following month.

3.5 Registrability

AN was reportedly on track to make properties registrable within the four-year minimum rental period required by the Institutional Subsidy. The City had provided the mother erf to AN on the basis of a Land Availability Agreement (LAA)[128], to save AN rates payment for five to six years (i.e. the period of construction plus the four-year minimum rental period). AN halted the sectionalisation process when the construction process was halted and it became clear that the project was failing, and it thus appeared that the conditions for transfer to beneficiary households would not be met.

[128] Jens Kuhn, personal communication, October 2019.

A few beneficiaries included in the project (7% of the beneficiaries accommodated) did, however, meet the lease payment conditions of four years but were not able to receive transfer.

3.6 Other important factors

Property rates and service charges

AN were not required to pay property rates in terms of the LAA.

Individual water meters were not installed in the development and the City billed AN for the water consumed on the site. AN was expected to recover the water charges from residents and aimed to do this through the rental charged to the residents. As rental collections dwindled, water arrears with the City built up.

5 FINDINGS AND LESSONS

In this chapter, we first consider the overall performance of projects and initiatives examined in Chapter 4, looking at whether they have been successful in their own terms. For the subsidised projects, have they been able to create opportunities for ownership in a sustainable way, without losses or costs for partners and financiers? For exclusively privately funded projects, have the initiatives been able to reach the gap market or how far are they currently from accessing this market? We also look at whether buyers have been able to attain gains in the capital they have invested in these schemes – a key rationale for deferred ownership schemes. That is, by deferring ownership and entering into lease and loan arrangements with sellers that fix the price to levels at the time of agreement, do buyers gain access to properties which grow substantially in value, beyond the price they paid for them, by the time they gain full ownership?

In this chapter, we also assess projects and initiatives using the normative framework developed and explained at the end of Chapter 2. This Chapter thus considers the extent to which risk concerns for instalment sales that have been drawn from the literature are addressed at the project level. In answering this question, Chapter 5 will also consider the extent to which the regulatory framework recounted in Chapter 4 is followed at a project level.

The assessment provides an opportunity to identify lessons for policy makers and implementers: actions to be avoided and practices to be followed. These lessons are identified as we proceed with the assessment in this section of the report. Given some of the specificities of the lease option arrangements, their risks are examined separately in Box 3 below.

Box 3: Comparing rental collections in directly supplied government rental units and privately supplied rental units

Rental performance

City of Cape Town

According to Malcolm McCarthy of the National Association of Social Housing Organisations, the best estimate of the rental collection rate across the Cape Metropolitan area up until December 2019 is between 18%[129] and 30%[130]. Table 7 provides a sample of Cape Metro municipality rental collection rates that reflect this poor rental collection performance.

Table 7: Sample of Cape Metro municipality rental collection rate per development for December 2019

Project Name	Number of units	% Rental collection rates before refurbishment	% Rental collection rates after refurbishment
Woodlands, Mitchell's Plain	400	35%	36%
Scottsdene flats	528	21%	24%
Scottsdene houses/maisonettes	117	10%	11%
Scottville houses	60	35%	14%
Hanover Park	1680	32%	35%
Kewtown, Athlone	320	50%	40%
Heideveld	864	32%	33%
Marble Flats, Ottery	688	26%	28%
The Range, Adriaanse	288	5%	6%
Connaught Estate, Adriaanse	304	29%	14%
Uitsig, Ravensmead	687	19%	27%
Manenberg	1584	28%	26%
Gabriel Court, Scottsdene	154	Newly constructed- no further information	35%
Hangberg, Hout Bay	71	Newly constructed- no further information	45%
Bunga Avenue Project, Langa	463	Newly constructed- no further information	4%
Average Rental collection rate		**27%**	**25%**

Source: Affordable Housing, WCDHS

[129] Department of Human Settlements. 22 June 2015. Investigation into implementation of the Community Residential Units Programme (CRU) and Development of norms and standards to be applied in the implementation of the programme. Draft Report, V01.

[130] Malcolm MacCarthy, General Manager, National Association of Social Housing Organisations (NASHO), personal communication, 9 March 2020.

Data acquired from the City of Cape Town lacked important metadata details including, but not limited to, the source of the data, how it was collected by the municipalities, the method for billing tenants[131] and the percentage of accounts in 90-day arrears. A clear definition of rental collection rates was also not forthcoming, but the data most likely reflect collection versus billing with historical arrears (over 90 days) removed[132].

The table shows a slight decrease in collections from before the refurbishment to after, despite the increase in quality of accommodation arising from the refurbishment. This trend suggests that the causal linkage between the quality of accommodation and payment levels is complicated. Although lessees may cite poor quality as a reason for non-payment, improving quality may not simply give rise to improved collections.

A rental collection rate of 36% across all municipalities in the Western Cape, including the City of Cape Town, has been reported[133].

Provincial housing department rental collection figures are not provided here, as the data received seemed highly problematic due to a lack of effective record keeping, the charging of variable rents and inconsistent application of the rental policy.

Private rentals

Data on private rental collections was more accessible and reflects the total collection versus total billing. This data puts the rental collection rate in the Western Cape in the private sector in quarter four of 2017 at just under 90%[134].

The private market's rental collection dramatically outperforms the municipal rental collection rate. This is in part attributable to private rental institutions following very strict administrative processes and procedures when selecting and screening tenants. Adherence to screening ensures less exposure to economically vulnerable tenants in comparison to government which needs to cater to the lower income market, including economically vulnerable and indigent persons. Also, having more up to date/accurate data allows private renters to detect and address issues of temporary indigence and act following late or non-payment. Private landlords are also not as susceptible to unclear political messaging, rental boycotts and political pressure not to evict defaulters.

[131] For example, it was not possible to determine if rental amounts were based solely on the property (size, number of bedrooms, etc.) or whether they included income-based thresholds for the tenants.

[132] Malcolm McCarthy, personal communication, 9 March 2020.

[133] National Association of Social Housing Organisations (NASHO) and South African Local Government Association (SALGA). 7 and 8 November 2012. *Municipal – SHI Co-operation on CRU and Municipal Stock Workshop*. Johannesburg.

[134] TPN Credit Bureau. 2017. *Increased Value Added Tax Is Set to Adversely Affect Tenant Payment Performance*. TPN Credit Group. https://www.tpn.co.za/Group/Home/Media

5.1 Overall performance

The performance of the historical subsidised deferred ownership projects studied in this report has been on the whole poor, with some pockets of better performance. Only in the **SOHCO Amalinda** lease option project has the aim of freehold ownership been reached for a significant majority of units subsidised. Besides the Institutional Subsidy, the SOHCO project received donor funding and loan funding from the NHFC, a DFI under the NDHS. The project kept its selling prices constant in nominal terms during the entire selling period of 12 years, experienced high capital appreciation of its units and addressed issues of building quality in a responsive fashion. The target number of units for ownership was also cut back substantially from the original level and replaced by permanent rental units to help manage the risks associated with the lease option units.

Lessons

In a lease option arrangement, keeping prices low and affordable over an extended period in a context of high capital gains for the buyer due to market appreciation is a significant factor behind success. This must be done by keeping prices at historical levels if the units were all built at a similar time and the financing terms remain stable.

Replacing lease option units with long-term rental units is a potential way to lower mortgage access risks while maintaining administrative economies of scale across the project.

Other NHFC financed projects experienced severe difficulties, which have led to substantial losses for the NHFC. In the case of the **HAB project**, the NHFC filed successfully for HAB, its debtor, to be declared insolvent. Eventually HAB's former assets, i.e. the property it had developed, were transferred to the City of Cape Town, with the NHFC being unable to recover any of its debt. Only seven of the 676 beneficiary households accommodated received transfer during the project. The City has had to use its own resources to make the property within the HAB project registrable, and it seems that the City is unlikely to recover any debt or other costs from original beneficiaries when the assets are finally transferred.

Lessons

Project failure has significant consequences for the host municipality, arising from the occupation of property without registration in the name of the occupier where the owner is insolvent or defunct.

In the case of the **CTCHC**, the NHFC, which took over full ownership of the company in 2008 following the advent of the Municipal Finance Management Act (MFMA), faces substantial losses after the Constitutional Court found in November 2018 that the CTCHC failed to record ISA contracts adequately in terms of the ALA and was therefore unable to legally collect instalments and enforce instalment payments. The NHFC indicated that it had to forgo interest receipts and that receipts prior to the recording of the contracts in April 2014[135] can be counted as capital payments. The arrears that it thought it could recover had to be written off. This means that only a small portion of buyer debt can be recovered. Figures are not available. CTCHC's Legacy Projects have tended to face more problems than their newer projects: ignoring the fact that payments cannot be counted as instalments, since 2000, only 63% of accounts have been settled to date, despite the longest maturity periods set in the contracts having ended in 2013. Newer projects appear to have

[135] Mhlantla, 2018, p7.

been more successful but are underpinned by higher real Institutional Subsidy quanta, and substantial in-kind subsidies provided largely by the City of Cape Town.

Lessons

Failure to comply with the ALA could have severe consequences for the seller, especially if the lack of compliance is extended over many years. It is critical that instalment sales contracts are recorded according to the ALA and the property sold is registrable.

The **AN project** was terminated in 2013 with 66% of the original target built, in the face of widespread non-payment amongst beneficiaries, the collapse of the Board of the community-based housing institution, which was the developer of the project, and protests from households not included in the project and refusing to leave the project site that remained in public ownership. The project was funded exclusively from the Institutional Subsidy and private donations, which have not been further drawn upon after the project collapsed. The project attempted to provide medium-density sectional title opportunities to subsidy-qualifying households living in an informal settlement on a school site, owned by the municipality, and which had burnt down. The project was managed by a board drawn from the School Site community. None of the units have been transferred to date.

Lessons

It is difficult to successfully establish a project, even if only partially funded by beneficiary contributions for an established locality-based community, where community members are given no real alternative and a significant proportion of the community is excluded from the project.

Exclusively privately funded initiatives have fared much better, but either do not manage to cater for the gap market or only draw from it in modest numbers at the top end of the gap market. **Chartwell** started an investment business in 2016, financed by an international pension fund, in which Chartwell purchases sections of residential construction projects commissioned from developers for resale through both instalment sale and outright sale. According to the mandate of the funder, 75% of the units developed must be priced at R700 000 or below. A R700 000 unit is more or less affordable to a household with an income of R24 000 per month[136], just above the cut off for the FLISP market (R22 000 per month). The lowest priced units are R520 000, affordable to a household with an income of R18 000 per month. Default rates for all instalment sales units are 0.5%, based on number of accounts.

Sentinel Homes is a company owned by Combined Finance, which was founded in 2014. Sentinel was established in 2017, and in March 2018 it registered its first instalment sale. Potential clients, who are aspirant homeowners, approach the company, often via bond originators or lease option facilitators, with a property they wish to buy in cases where banks have declined mortgage loan applications. The company will purchase the property after a positive assessment of the applicant and property and sell it to the client on instalment. The company's purchases are bank financed, with each property mortgaged to the bank on the basis of a "continuing covering mortgage bond", which provides a funding facility to Sentinel secured by properties it purchases. Currently the company has 60 instalment loans totalling R100 million on its books. The average loan is approximately R1.5m, but the company will buy properties with a minimum price of R400 000 (although the frequency in the band affordable to potential FLISP beneficiaries of up to R650 000 in value, is very low). Interest rates range from prime plus 50 to 150 basis points, and although the amortisation occurs across 20 years, the period of the loan is 10 years, with the option to renew the

[136] Assuming interest rate of 11% (prime plus 1) and maturity period of 20 years, but not taking into account other recoverable amounts charged monthly which will lower affordability somewhat.

instalment loan. The company provides only a 95% loan, requiring a deposit of 5% of loan value plus an additional mark-up to cover the transaction costs of the purchase of the property by the company, including property registration and bond registration fees, which can be substantial. In the case of a property bought for R600 000, the mark up is approximately R60 000 and the deposit is R30 000.

Lessons

It appears difficult for private companies who are either developing units for instalment sale or buying and reselling units for instalment sale to reach into the FLISP market. It is not clear that the instalment loans cost the buyer less than mortgage loans. A detailed study that considers the value of the property purchased, based on "all-in prices" and total monthly repayment for all associated costs, is required. Transaction costs incurred by the seller associated with the instalment sale include transfer fees incurred, bond registration fees, if the property development or sale is mortgage financed or transaction costs linked to other forms of finance, and taxes like VAT and transfer duty (where applicable). These costs may be built into the price if the buyer is the developer/investor or charged as an explicit mark-up on the price, if the buyer buys and resells existing property. Besides monthly instalment loan repayments, buyers also have to cover insurance payments that the seller requires, property rates (usually charged to the seller and recovered from the buyer) and municipal service charges and body corporate levies, if the property is sectionalised.

A government subsidy programme, such as the FLISP, aimed at private initiatives supporting buyers, would need to consider whether to restrict subsidies to reducing the capital amounts on the loan or whether to include lowering transaction costs.

5.2 Capital outcomes for beneficiaries

A capital risk is the risk that the market value of the unit being sold through the deferred ownership mechanism will be lower than the selling price at the point of transfer, with inflation considered. The market value depends on the state of the property market and, to some degree, on the physical condition of the unit. Capital risk also arises from the tenure arrangement in terms of which the property is held – property that is not transferable to the buyer essentially has no market value for the buyer.

Instalment sales

It seems that in the **CTCHC** projects no capital losses have occurred. Market prices are above the prices at which property was sold to households and these market prices are realisable during the instalment sale, as the units can be sold and transferred to a third party. There were, however, some delays in the ability of beneficiaries to realise capital gains due to the lack of registrability in Legacy Projects. Even though non-payment by buyers was a widespread problem, it did not appear to undermine the project to the extent that paying individuals were deprived of capital gains. The project was probably kept afloat by some degree of buyer payment at the aggregate level across projects, and, in Legacy Projects, the injection of subsidies for the maintenance of units, which may have resulted in increases in willingness to pay, and in newer projects, augmentation of the Institutional Subsidies with other urban services subsidies. The ability of the NHFC to sustain losses on the loan component of the project and ultimately write them off certainly also helps mitigate capital losses for buyers. Additional subsidy injections to address quality issues some way into the instalment period increased property values without any concomitant buyer contribution and certainly also lowered capital risk.

The private instalment sale schemes are still new and cannot yet be assessed for general capital risk. The risk may certainly be heighted by the recent downturn in property markets in certain areas.

Lessons

Capital losses for buyers can be avoided or mitigated by subsidies and by good project location decisions.

It is critical that the property be registrable to avoid losses, and registrable from early in the instalment sale process so that capital contributions can be retrieved if the buyer gets into financial trouble. If parties adhere to the ALA, these latter conditions can be met.

The gains in capital for buyers are a critical factor in retaining good payment levels in ISP projects/schemes and in being able to exit buyers who cannot keep up with payment levels.

Lease option

SOHCO's lack of buyer capital risk is underpinned by frozen nominal selling prices during the leasing and selling period, the quality of the product and property market performance in the Amalinda area of East London.

Beneficiaries in other subsidised lease option projects have all faced some capital risk, as the projects have been undermined by non-payment, lack of registrability of some of the property developed and, probably, in the case of **HAB**, unit products of poor quality. In the HAB project, a small minority of beneficiaries (seven in total) could take transfer of the units, but it is not clear that the units have appreciated in value since transfer.

Beneficiaries of **AN** stood to achieve substantial capital gains, due to the quality of build, and the high level of subsidisation. The risk related to the sustainability of the project: the ability of the project to sustain the contributions by beneficiaries and deal with households who did not qualify but were part of the School Site. Seventeen households were not able to enjoy capital gains, even though they reportedly met the requirement of complying with their lease for four years, as they were not able to take transfer because the sectionalisation process was not complete, i.e. the property was not registerable. These 17 beneficiaries did not, however, face capital losses, as the contributions they had made during the minimum lease period merely covered operational expenses – all the capital was covered by government subsidies and donations. Some AN beneficiaries have been able to earn income on their units in the form of rent, despite not owning them.

It is likely that the original beneficiaries (where they still occupy the units) will eventually be given transfer in both the HAB and the AN projects under the auspices of the national Title Restoration Project. Capital gains are thus likely to materialise in the long run for these beneficiaries. While government losses are present in both projects, they are limited in the AN project, due to substantial private donations.

Lessons
The lack of property registrability seems to be a key factor underlying the risk of capital loss for the aspirant buyer. Property should be registrable by the end of the lease period at least.

5.3 Assessing the management of risks in projects and initiatives

This analysis of how risks were managed is based on the normative framework developed in Chapter 2. Instalment sale projects and initiatives have been distinguished from lease option projects where this differentiation adds to the analysis. Buyer risks and seller risks are examined in turn. Section 2.4 has pointed out that there are some risks that affect both parties. These shared risks have been reported at the end of section 5.3.2 which covers seller risks. This chapter is evaluative, using evidence drawn from Chapter 4 and referenced in that chapter.

5.3.1 Buyer risks

a) Security over the fixed asset

As indicated in section 3.1, a key way of protecting buyers' security over the capital in the property being bought via an instalment sale, is the recording of the agreement in the Deeds Office. The **CTCHC** failed to record its ISAs timeously across nearly all its projects, despite indicating in all its Legacy Projects agreements that it would do so. The reasons for the lack of recording are not clear. The problem was corrected in 2014 but has resulted in substantial losses for CTCHC's funder and owner, the government funded DFI, the NHFC, as indicated in 5.1 above.

During the case study discussion with the CTCHC, it was mentioned that the instalment sales agreements may have been recorded against the title deed of the mother erven. Such recording has a number of disadvantages compared to recording the agreement against certificates of registered title for the property being sold in instalment. Recording on the deed of the mother erf is a time-consuming operation in the Deeds Office if there are a number of agreements that have be registered, as the acts of endorsement can only be carried out in series. Certificates of registered title allow for recording of agreements via endorsement to occur in parallel. Furthermore, the preparation of certificates entails several of the same steps that are required to get the mother erf registrable. Recording the agreement against certificates of registered title for erven to be sold in instalment thus has an in-built check for making the land parcels registrable (see 5.3.1 e). Furthermore, by making use of certificates of registered title to record the contract, the seller will not be in breach of the 5-year restriction in recording contracts against the mother erf (see ALA 6 (1) q and the 6(4)). If the 5-year period lapses, either party can cancel the agreement, placing the agreement in jeopardy.

Private instalment sales initiatives are recorded against the individual property's title deed. As private sellers first purchase the properties before selling them via ISAs, all properties already have title deeds before the ISA is finalized.

In the CTCHC set of projects, the property created was encumbered only in newer projects, where a mortgage was placed on the mother erven for the development by the NHFC to secure its loan to the CTCHC. The ISA makes no reference to these mortgages and it seems that buyers were not notified of the underlying mortgage setup prior to agreement, as required in the ALA. Furthermore, up until 2014, the ISAs were not recorded against the title of the property, and so the preferent claim protections provided under the ALA in the case of the insolvency of the NHFC, or if the property is subject to a sale in execution by a mortgage provider or other debtor, would not have applied. The risk imposed by the mortgages on the buyers is not all that clear, however, as the CTCHC is wholly owned by the NHFC, it does not make sense for the NHFC to act against itself. The mortgages were probably set up by the NHFC to secure the loans, should the CTCHC have been sold. It is also not clear that the CTCHC, given that it is currently an entity wholly owned by government, would face insolvency or would be forced to sell assets to cover debt.

Chartwell's funder does not secure its funding through mortgages on the property created, and so buyers do not face the risk of Chartwell's funder foreclosing on their properties.

Sentinel has taken out loans on the properties it has sold under instalment, and given that Sentinel follows the ALA, the ALA's standard protections pertain.

Both **Chartwell**'s and **Sentinel'**s instalment buyers enjoy the protection against insolvency and sales in execution provided by the ALA. Furthermore, in the case of insolvency of the seller, as discussed in section 3.4(a) above, there are incentives provided by section 63 of the Insolvency Act for liquidators to continue honouring the instalment sales agreements according to terms no worse than those established between the seller and buyer before the insolvency event. The interest of the buyer would be protected by such an arrangement.

Lessons

Provisions in the ALA are mandatory, crucial mechanisms for providing security for buyers over the asset being purchased. All instalment sales projects and initiatives should comply with the ALA.

In new property developments, in which the developer sells property directly to an instalment seller, certificates of registered title should be used to record ISAs.

Incentives in the Insolvency Act for the liquidator to continue the business of insolvent entities provides additional protection to buyers.

b) Retaining capital stakes and benefitting from capital gains should the buyer withdraw from the sale

Instalment sales

Buyers in an instalment sale face the risk of being unable to withdraw from the contract without loss of the capital contributions they have made or any gain in the capital value that has accrued to the property over the course of the contract. This risk has been addressed in the ALA, mainly via section 28 read with section 6(1)(m), which provides that the buyer is able to recover net capital redeemed through loan repayments and capital gain in the property during the contract. Section 28 provides that the buyer's claims would need to be offset by what the seller can recover, which is reasonable compensation for occupation or use of the property during the contract. The ALA also provides for the recovery of monies spent on upgrades and maintenance by the buyer and seller depending on which party retains the property upon withdrawal from the ISA, and the nature of the maintenance and upgrades.

The **CTCHC** has provided for cancellation of the ISA within its contracts, but at a general level. The contract does not explicitly cover what the buyer and seller can recover or how the amounts are determined.

Chartwell and **Sentinel** indicated that their contracts with buyers were compliant with the ALA. They did not provide their contracts for the study, as they are considered proprietary information. Chartwell emphasised that they facilitated exit of the scheme at the request of the buyer via a sale to a third party, provided all the capital and arrears owing to Chartwell could be recovered from the sale. Thus, any capital paid into the loan and capital gain made on the sale can be retained by the buyer. Sentinel indicated in the light of section 125 of the NCA and 17(c) on the ALA, the buyer can settle the loan account at any time regardless of the funding of the settlement, including a third-party buyer. Sentinel requires an acceptable bank guarantee that it will receive payment from the third-party buyer before transferring the property to the instalment buyer for immediate transfer to the third-party buyer. We can refer to these exit mechanisms as **"dignified"**, as they allow the buyer to exit the scheme with contributions and gains made.

Lessons
The ALA provides a good schema for the protection of the buyer's capital interest in the property during the course of an ISA agreement.
Instalment sales agreements should make explicit reference to the relevant clauses and explain them clearly, and the seller should facilitate their implementation if either party has to withdraw.

c) Dealing with capital retention of heirs of the buyer, i.e. beneficiaries of deceased estates containing the property

The municipality does not value individual properties in instalment sales developments in which new properties are developed (see 5.3.2 below). This omission means the Master of the Court cannot use the property valuations to determine the value of the deceased estate, which includes the property. This has occurred in the **CTCHC** projects. Determining the value of the estate is a key step to transferring the property to the deceased estate, as the Master requires the value to determine the type of executor required, and the latter is required to distribute the estate to heirs. Without an official way of determining the value of the property, the property cannot be included within the estate and the property remains frozen. Even if the instalment loan has been paid off, transfer cannot be executed.

The above is not the case in the private projects studied in this report, even in those where the municipality charges property tax on the whole development. In the case of Chartwell, the sectionalisation process and the registration of the sections in the Deeds Office provides the basis for the quantification of municipal property valuations that are officially recognised.

Lesson
The lack of a municipal valuation for the property being created in new freehold developments creates a serious impasse for beneficiaries of deceased estates which include such properties. All stakeholders should work to address this omission with the authorities overseeing the administration of the property tax system, i.e. the National Treasury and the Department of Co-operative Government and Traditional Affairs (COGTA).

c) Quality of the fixed asset

Nearly all historical Institutional Subsidy projects displayed building quality issues. As outlined in 5.3.2 b) below, building quality issues make projects susceptible to political interference and payment boycotts which impact negatively on sustainability.

A key mechanism for controlling product quality, i.e. the choice given to the end user, consumer or buyer over the product acquired, was not available due to the nature of the subsidy. The subsidy, which required beneficiary approval for release, was used to fund construction, severely limiting consumer choice.

The way some early subsidy projects (**CTCHC** Legacy Projects and **HAB**) were established, undermined the mechanisms for quality control or safeguarding linked to i) the physical construction process, run by the municipality, and ii) the release of subsidies, usually managed by the Department. The central involvement of the municipality in the management of the developer/housing institution often meant that municipal procedures usually required of all construction were circumvented, at least initially. This practice had two effects. First, key processes like building plan approval and building inspection were omitted; and second, as these procedures were preconditions for the property transfer registration process, these processes were delayed until they could be addressed in some form (see below).

The progress payment system for the Institutional Subsidy did not seem to function optimally in the CTCHC and the HAB projects, as it seems that lumpsum payments were made from housing funds held by the City of Cape Town to housing institutions, as the Provincial Department held insufficient grant resources at the time. The City of Cape Town was given permission to press ahead to use funds in its Special Operating Account. While it seems that products were delivered for each of the beneficiaries approved, progress payments to the developer were not made conditional on achievement of adequate quality for all units at each stage or typical milestones of the building process.

The initial questions around building quality in the two projects, and indeed some proven lapses in building standards, led to interventions by the City and the Provincial Department, usually in the form of additional public resources to address shortcomings. A very costly multiple year process of quality review and correction was instituted in the CTCHC Legacy Projects, although reportedly no major structural problems were found. It seems that the questions and lapses led to difficulties in distinguishing between behavioural issues related to the use and general upkeep of the units, and issues related to latent defects and major structural problems.

The **AN** building process was run strictly according to municipal building control procedures and the building quality achieved was reportedly high. Maintenance issues, at least in part, were due to the collapse of rental collections and lead to a vicious cycle of declines in rental collection and in maintenance.

All new CTCHC and AN projects were registered with the NHBRC.

The **SOHCO** case study underlines the need to take quality issues seriously. Although SOHCO thought the problems that were raised by aspirant buyers were relatively minor, it did all that was required to address the problems.

Chartwell reportedly takes building quality very seriously. Its unit specifications are carefully considered and strictly implemented. Although Chartwell commissions the units from private developers, it pays only for the units that meet its standards and deploys its own staff during construction to inspect the building process to ensure that the required standards are met in both the substructure and superstructure.

Sentinel takes several measures to ensure its liability in relation to building quality is minimised. Sentinel employs accredited property valuations providers to value the property and check that properties comply with municipally approved building plans. The currency of the NHBRC warranty of the property is checked. In relation to the implied warranty provided for in the CPA, Sentinel maintains it mitigates its risk by having the client confirm in writing that the property being financed is the one they identified themselves and that it is in good condition (warrant of fitness for purpose). Whether this arrangement absolves Sentinel of a broad ranging implied warranty remains to be to be tested in court.

Lessons

It seems that there are many measures available in South Africa for ensuring building quality and protecting the interests of consumers. Sellers should use these measures to ensure consumers are satisfied and that they do not contravene legislation.

Plugging subsidised new build deferred ownership projects into the DHS inspectorate system, and all projects in the municipal building control system, is a minimum cost option that could be beneficial.

The protection offered by the implied warranties in the CPA for deferred ownership secondary sales if the buyers choose the unit requires further investigation.

d) Taking on debt to purchase the fixed asset

Instalment sales

The **CTCHC** did not appear to pay sufficient attention to the affordability of monthly payments for buyers in the beginning stages of its Legacy Projects. Interest rates were set very high to correspond with the very high repo rates at the time, while the constricted maturity periods of 5 years meant instalment amounts were relatively high. It was thought that the relatively high instalments lead to non-payment and an "Affordability Programme" was introduced to reduce instalments by lowering sales prices through the introduction of an additional capital subsidy and providing the buyer with the choice over maturity periods.

Over the course of its existence and with the advent of the NCA in 2005, the CTCHC became more focused on affordability, capturing more subsidies from the municipality to lower the amount owing on the property, i.e. the size of the instalment loan, and increasing the maturity period to the extent that it eventually reached 25 years in Harmony Village. Keeping minimum instalments constant in nominal terms over the entire maturity period also assisted in keeping payments affordable, as real instalments declined over the maturity and created space for additional capital payments and reduced overall interest payments. These initiatives were undermined by the build-up of arrears and interest charged on these arrears.

Private sector companies have tended to keep their instalments and other monthly payments to levels that equal mortgage payments and costs associated with accommodation. In the case of **Chartwell**, body corporate levies and other recoverable amounts (which include water charges and property rates), tend to be at levels that impact significantly on the ability of gap market households to afford entry. **Sentinel** reports that its loan deposit requirement and upfront mark-up appear to be significant barriers to entry for the gap market to its scheme.

Sentinel uses a somewhat unorthodox structure for its instalment loans. Although its loans follow a 20-year maturity amortisation structure with interest rates that are very like those of mortgages, the loans have a 10-year maturity with options to enter into new loans after expiry. The structure reportedly allows for better alignment in the maturities between its loan offering and the finance it has available from banks to fund those offerings. The impact of this arrangement on interest payments over the life of the loan requires further investigation and would depend on how interest rates change between loans and the size of penalties for accelerating payments. The size of the penalties for accelerating payment is capped by regulation. Penalties can only be charged if the loan is settled before the agreed end date and can be avoided altogether if the buyer gives the seller three months' notice that the loan will be settled before time.

Beneficiaries in the subsidised projects frequently report that they face spending shocks that undermine their ability to continue to pay contributions. Projects have developed solutions to deal with these shocks, but each has weaknesses and disadvantages. Most of the subsidy projects provide some leeway in payments that can accommodate small shocks. However, this leeway could create a barrier to achieving payment stasis when the shock passes, in that interest is charged on arrears and arrears can thus grow exponentially due to compounding.

Privately funded schemes insist that their buyers obtain income insurance, to cover non-principal payment obligations in the case of income loss for a limited period. Instalment sellers with a significant client base can organise group schemes, which generally lower the cost of insurance and increase the cover period. While the benefits are clear, the monthly premium lowers the affordability of monthly payments.

Lessons

Sellers are required to check for the loan affordability of the buyers before providing instalment loans. Instalment payments should be fixed over the course of the loan, which should have extended maturity periods to improve affordability and be underpinned by a diversity of funding sources to ensure financing sustainability (see 5.3.2 g).

The fees for any income insurance requirements should be kept to a minimum and sellers should seek to lower insurance costs, for instance, by establishing group schemes.

All monthly fees associated with the property, and not just the loan instalment, should be considered when assessing buyer affordability.

Escalating instalments

In 2019, the Department received unsolicited bids to provide support to an instalment sales project. The developer was not very precise in their request for support, but at least asked for free or discounted serviced land and/or upfront payment of a loan deposit subsidy prior to construction[137]. The maturity periods proposed were half the normal 20 years for a mortgage, and although interest rates lay within the range usually used by banks for mortgage loans, monthly instalments were set to escalate on an annual basis at twice the rate of CPI inflation. Such an arrangement would soon become unaffordable for gap market households, leading to arrears and possibly loss of the asset.

Lessons

Mandatory escalating instalment sales built into ISAs should be avoided. Discretionary increases to instalments activated by buyers should be strongly encouraged by government and sellers. Buyers should be able to revert to the original instalment payment provided in the ISA at any time without penalty. In addition, subsidies in addition to the capital subsidy for the unit are likely to prove unsustainable.

e) Buying and gaining transfer of the property

Instalment sales

It would also seem that the **CTCHC,** at least in its Legacy Projects, did not make the property it was selling registrable at the time of the instalment agreements and the collection of instalments. The reasons for this include the failure of the CTCHC to follow municipal procedures for township establishment and construction, which are preconditions for making properties registrable, and the

[137] TMG Group and Intastor (no date) *Housing: Rent to own housing opportunity (RTO).*

failure of the City to get them to follow procedure until late into the instalment sale period. The failure of the City, the owner of the land at the time, to determine selling prices for the properties contributed to the problem. It seems the process of making the property registrable was better followed in the newer projects.

In the private sector-funded projects, all properties sold tend to be registrable. For **Chartwell**, the unit development process includes sectionalising the development. Sectionalisation occurs before the instalment sale to ensure that body corporates can be established right away.

Sentinel have only transacted in the secondary market, in which units have been exchanged at least once already, and so are registrable. As Sentinel is not a developer, even if it sold newly constructed houses, it would first have to purchase them, which would require that the property be registrable (and can be seen as a check for buyers).

Lease option

It is not clear whether there are any express regulatory requirements that property being sold via a lease option arrangement be registerable, but clearly for the buyer to exercise the option to purchase, the property would need to be registrable at the point the option falls due.

In all of the subsidy financed projects, the properties were not made registrable within the four-year minimum lease period. In the **SOHCO** project, sectionalisation did not take place in time to enable buyers to take transfer directly after the four-year minimum should they have obtained finance to purchase. This lack of registrability was not an issue as the lease period had to be extended to enable the lessees to obtain mortgages.

In the **HAB** project, although the City sold the land to HAB, it appeared that a significant portion of the sites were actually transferable, but transfer did not take place at the time. Another portion were not transferable due to an incomplete township establishment process. It seems that there was encroachment over the years which will require the resurveying of units, although the original approved General Plan may still be valid. HAB appears to have constructed property on land that fell outside of the parcels. Presumably, these parcels fall within the City's transfer programme.

Lessons

In new developments that supply instalment sales units, sellers should ensure that the property is registrable before they enter into deferred ownership agreements.

Box 4: Lease option: checking whether "red flag" concerns identified in Chapter 2 apply in case studies

In 2.1.1.2 we indicated that the lease option arrangement may pose a considerable risk for aspirant buyers, especially during the leasing stage. During the leasing stage the aspirant buyer has limited rights over the property: the seller is definitely the landlord, and the aspirant buyer has no real capital stake in the property. The seller may be able to encumber the property before the option to purchase arises, or even transfer the property to another buyer.

In 2.1.1.1 we indicated areas of concern that could lead to an increase in the risk faced by buyers. In this box we consider whether the cases studied in this paper, which are all subsidised lease option projects, have these concerns.

Rentals in the lease period are substantially above market levels

During the lease period, between taking occupation and buying the unit, **SOHCO** attempted to control rents by limiting the cost items recovered through rental to the interest on the loan and the operations of the housing complex. As interest rates declined over the period, interest payments dropped and **SOHCO** could keep rental increases to a minimum.

AN was extremely conscientious about affordability and could keep monthly leases to levels that many households were paying to informal landlords in the informal settlement prior to the project. The low rents were possible because the entire capital component of the project was funded through subsidies and donations. A rent relief fund financed from the monthly rentals was also established. The fund was application-based and open to pensioners, very low-income households, households affected by disability and chronic illness. Applications were considered by the Board, but the fund was limited by collections, operations and maintenance. Despite these measures, non-payment proved to be a severe problem in the AN project.

Option price very substantial

None of the projects that were examined had option fees. As option fees are usually merely additions to the sale prices that go to the seller, they diminish the capital gains which can accrue to the buyer during the lease period and also mean that capital gains for the buyer are residual after the defined fixed level in the fee accrues to the seller. The absence of option fees meant that all the capital gains accrue to the buyer.

Option validity period very limited

A fixed period over which the option to purchase is valid limits the aspirant buyer's search time for finance to take up the option to purchase and improve his or her credit rating. The option period was not strictly enforced in any of the projects studied. In the **SOHCO** project, the validity period was essentially doubled to eight years.

Thus, none of projects studied showed the "red flag concerns" for lease option projects. However, our preliminary study of privately funded lease option initiatives indicates that these concerns are very likely to be present for these projects.

Lessons

Capital risk for aspirant buyers is lowered considerably by the lack of option fees, extendable option validity periods and lease period rentals set at the market rate of rentals and not above.

5.3.2 Seller risks

a) Enforcing payment and the eviction regime

Nearly all subsidised deferred ownership projects studied in this report have faced substantial payment problems. In the case of the **HAB** and **AN** projects, non-payment problems contributed significantly to the failure and demise of the projects. The **CTCHC** also faced significant non-payment problems, as illustrated in the accumulated payment arrears in October 2019 of just over R32m. It seems that political factors played a key role in non-payment: residents were either encouraged not to pay or were not discouraged from non-payment.

The **HAB** case also illustrates that billing and accounting systems are critical for payment. HAB payment systems were apparently manual and entailed door to door collections. They were not credible to renters and open to abuse and leakage.

Contractual enforcement is clearly also a key factor in payment collections, as recounted by CTCHC. Much of the problem seemed to arise from strategic behaviour on the part of buyers occasioned by the notice requirements given in the NCA.

It would also seem that subsidised sellers found it difficult to cancel agreements in severe arrears and, if necessary, evict beneficiaries. This is in part due to the regulatory framework that makes eviction difficult. But it also relates to political support for housing institutions and the ability to offer a dignified or attractive voluntary exit from schemes for the beneficiary. Such exit is more likely in instalment sales where the buyer's rights are provided for in law, i.e. the ALA. We can refer to an exit where the costs for the buyer are low, and the buyer can retain capital payment and capital gains as envisaged in the section 28 and section 6(1)(m) of the ALA, while the seller receives compensation for capital it is still owed and arrears, as a **"dignified exit".** As indicated in 5.3.1 b), Chartwell and Sentinel have such mechanisms in place.

Providing an attractive exit in a lease option arrangement during the lease period is more difficult due to the nature of the lease.

Non-payment in the **AN** project is probably linked in part to the origins of the project and how it was funded. Beneficiaries were given no alternative to the contribution-based project and could thus not elect to withdraw. The stakes for non-payment were not seen as very high, as beneficiaries did not understand the benefits of formal ownership and were unlikely to be denied usage rights to the assets created, i.e. be evicted. As the project was not loan-financed to any degree, there was no loan provider seeking payment.

Private sector companies operating without subsidies appear to have greater success with payment. **Chartwell** has reported very low levels of default, in which Chartwell cancels the contract because the buyer is in debt. Better results no doubt reflect the much higher average household income in its projects and the payment protection offered by the insurance products buyers are required to purchase.

Lessons

Payment collection systems need to be run tightly. The provisions in the NCA for notifying debtors of arrears and taking action (notice periods, fees and fines) give scope to buyers to postpone payments and build up arrears. To avoid strategic behaviour by buyers, agreements need to define what constitutes a default and what buyers are required to do to address a default adequately.

Sellers should be encouraged to devise "dignified exit" mechanisms for buyers, as a way of encouraging buyers struggling to keep up payments to leave the scheme, thus managing non-payment.

b) Political interference or lack of political support

Dissatisfaction with the quality of the units sold often provided the pretext for political interference. The pre-occupation with the quality of units was probably in great part due to the contributions required of the beneficiaries, who could also theoretically qualify for free housing. The calculus for these beneficiaries could be along the following lines: "If I have to contribute to the cost of the unit, it should be of a significantly higher quality than a free subsidy house". It seems that only in the case of **HAB** was there any real case of poor quality to be made.

The **SOHCO** project managed to avoid sustained non-payment problems by SOHCO taking small quality problems seriously soon after these arose, and working with a representative committee of beneficiaries to promote the benefits of property ownership, particularly the gains that would accrue (including capital) to beneficiaries from the continuation of the project.

In relation to **AN**, the lack of political support of the project may have been related to not wanting to take sides with either the qualifiers in the project or the non-qualifiers who were required to leave the project area.

The spatial concentration of projects increases their susceptibility to political influence, as a new constituency may be able to be built quite readily.

Lessons

Projects financed by a mix of subsidy and beneficiary contributions are susceptible to political interference.

Politicians should guard against too much involvement, especially by not removing incentives for payment. Politicians should rather focus on ensuring that government agencies follow the rules when establishing subsidy projects and that measures underpinning building quality and affordability are adhered to.

c) Maintaining the capital value of the stock under instalment sale

The capital value of the seller's physical stock can decline through downturns in the property market or deterioration in physical stock due to poor maintenance and upkeep of the property. Managing risks related to the former is beyond the scope of this report. Regarding the latter, the ALA provides for a system in which buyers and sellers are "reasonably" compensated for maintenance and upgrade spending by the other party, depending on which party gains access to the property at the point of cancellation. The Act states, in section 28, that compensation of the buyer for maintenance spending is not necessarily tied to whether the seller gives permission for such spending by the buyer. The ALA characterises sellers' claims in relation to maintenance as "compensation for any damage caused intentionally or negligently to the land by the [buyer]." Buyers' claims can be for "necessary expenditure … regarding preservation of the land or any improvement thereon" given "with or without the authority of the seller" or "improvement which enhances the market value of the land" given "with the express or implied consent of the owner".

None of the agreements to which the study had access, seem to adequately capture the provisions of the ALA. For instance, the contract for the **CTCHC** Harmony Village project states that "the seller shall not be liable for any payment for improvements and repairs affected by the purchaser to the property". Besides appearing to be outside of the law, this measure may not best protect the interests of the seller as the buyer is given no incentive for maintaining the property over the whole life of the asset, including in cases where the buyer may be uncertain about retaining the property. On the other hand, measures that allow sellers to retain instalments to restore the property to its earlier condition in certain circumstances (e.g. death of the buyer), may work to create an incentive.

Lessons

While there appears to be a set of measures in contracts to ensure that necessary maintenance can occur, the system does not seem optimal. Creating "dignified" mechanisms of exit for buyers through which they will be able to retain any gain in capital during the instalment sale period, subject to certain arrears and cost claims from buyers, may go a long way to ensure that the stock does not deteriorate and that sellers are able to retain the value of what is due to them without discount because of maintenance issues.

d) Regulatory or legal confusion/uncertainty

During the case study process, some respondents reported that the courts have problems understanding the tenure status of buyers in instalment sales agreement and lessees with an option to purchase their units. The view is that courts seem more reluctant to grant eviction orders in the case of persistent default because they view the buyers and lessees as having greater rights than more "normal" tenants. Magistrate's courts have been reluctant to act and have serially postponed hearings and judgements. Private sector companies have mentioned that should eviction be required, they will approach higher courts, as they feel it is important to set a precedent, despite the cost.

It also seems that where eviction orders have been granted in some subsidy funded projects, housing institutions have never followed through. The housing institution or the municipality has usually been reluctant to implement this due to political factors, resistance from the buyer community, or the practicalities around eviction, such as the presence of evictees and their limited capacity to find accommodation.

In the case where a developer did unambiguously go through with an eviction (in **CTCHC** projects in 2014), the eviction was subject to a High Court, and ultimately a Constitutional Court, challenge. CTCHC lost the case on the grounds that they were not permitted to collect instalments, as they had not recorded the ISA contracts, and thus the arrears were not technically possible. The Court found that CTCHC acted too quickly to evict after the recording of the contracts in 2014 and did not allow sufficient arrears to build up before sending default notices and acting on the lack of response from buyers.

Lessons

Developers need a very clear understanding of the legal framework underpinning deferred ownership, especially the consumer protection information.

There is general ignorance about deferred ownership instruments and the rights that result, and the sector should seek to address this understanding at several levels.

Developers, especially those of subsidised projects, should seek to monitor and manage buyer/lessee accounts very closely, promoting the exit of buyers/lessees as a solution to non-payment and the build-up of debt. Exit through cancellation of the Institutional Subsidy approval or via third-party sales should be encouraged before arrears accumulate. This requires political will from the housing authorities who provide the subsidies.

e) Property tax liability

Instalment sales

According to the ALA, the buyers are liable for the payment of property rates and service charges associated with the properties. However, municipalities are reluctant to recover both of these types of payments directly from individual buyers. This is especially the case in project developments of instalment sales units, those that are both subsidy-financed and wholly privately financed. In cases where instalment sale units are individual and dispersed across the general housing stock, it seems that some municipalities will charge individual households for some services (in much the same way that tenants can have service accounts with the municipalities).

It also seems that for subsidy financed developments owned by social housing institutions, some municipalities provide 100% property tax rebates for units during the instalment sale process before transfer has taken place. There appears to be some confusion about the application of this policy in the City of Cape Town – the **CTCHC** has reported that it has received rates bills from the City and is currently in arrears.

There is a risk for sellers associated with the collection of payments from buyers: sales of units to third parties as a risk management strategy for both buyers and sellers is jeopardised by the build-up of arrears, as municipalities cannot grant rates clearance certificates required for property transfers in the presence of arrears. Privately funded sellers have tended to address this risk by including property rates within the levies linked to instalment sales to ensure that rate payments are up to date. Where service charges are not recovered from individuals by the municipality, they are also included in monthly levies charged by the seller to the buyer. These charges increase the collection and administrative burden on the sellers and raise the size of monthly payments they collect which could increase the risk of payment default. But they also make the remedy for default, a sale to a third party, easier to apply.

Lease option

The assignment of responsibilities in lease option sales seems to be clearer regarding the billing for property rates in that the seller is responsible for payment. For service charges, the situation is like that for instalment sales.

It seems the confusion around the application of property rates rebates for housing institutions also applied to the lease option schemes. Rates arrears built up prior to liquidation of the **HAB** and was one of the blockages for transferring the property back to the City. Rates arrears had to be specifically written off using housing grant money that could have been deployed elsewhere. Furthermore, it is probable that the attempt by HAB to recover property rates from prospective buyers through rent contributed to non-payment problems.

Lessons

It is critical that the municipality is clear about its property rates and service charge billing policy, that this be stable and that it be implemented in a consistent manner.

Municipal finance oversight bodies and housing authorities should monitor these aspects of policy. Any gaps in national policy and provincial policy should be addressed.

f) Ability to select beneficiaries

In nearly all the case studies it seems that developers and housing institutions have largely been able to select beneficiaries with a relatively free hand, selecting beneficiaries freely from the population that qualifies for the institutional framework.

Buyer payment records in Institutional Subsidy projects suggest that institutions have been poor at selection. It is likely that the focus in the earlier projects was on construction rather than on selection. Certainly, in the newer **CTCHC** projects, more attention was placed on selection, probably due in large part to the requirements of the NCA. Payment performance seems to be significantly better in the new projects.

Private institutions go through a rigorous process of selecting buyers, in part due to requirements of the NCA.

Discretion of the seller in selection was, however, significantly curtailed in the **AN** project, which was established specifically to provide all households on a confined physical site (the School Site) who qualified for an Institutional Subsidy, with a housing opportunity. The ability and propensity of beneficiaries/buyers to pay was not considered as beneficiaries were not required to make a capital contribution.

Lessons

Sellers should be allowed to select buyers for instalment sales and lease option based on primarily their ability and propensity to pay. Seller discretion should be strictly maintained, provided the seller is being fair and non-exclusionary.

Only projects on greenfields sites, where the seller has discretion over beneficiary selection and beneficiaries have a real choice to be part of the project, should developers attempt to make use of funding sources based on user contributions.

g) Economies of scale and diversity of funding

Instalment sales

Affordable instalment sales contracts tend to have long maturity periods, in the order of 20 years, although on an individual level the actual term of the instalment loan tends to be quite variable. Such a configuration often gives rise to a diminishing need for payment administration within projects over time and rising administrative costs over time, as economies of scale are disrupted. Maintaining administrative economies of scale over time requires the continual development of new projects and an expansion into these new projects. Essentially, if instalment sales developers are to keep their businesses running for a long time, they will be exposed to risks associated with market variability and sustaining buyer payments, and therefore require long-term finance.

The securitization of the debt may be one method to limit the term of involvement and thus reduce risk. One question related to this strategy is how buyers may be affected. The retention of the original developer to continue to manage payments for the holder of the securitised debt on an agency basis may help address issues around the continuity of service for buyers.

The **NFHC**, the government funded DFI, has proven to be a reliable long-term funder, but has suffered substantial losses to the extent that it has withdrawn from funding deferred ownership arrangements. **Chartwell's** single international funder seems committed and is reportedly satisfied with its performance. Any withdrawal, however, is likely to jeopardise Chartwell's instalment sales business substantially. **Sentinel** seems to have tapped into a local funding source that is likely to be sustainable, as it allows banks to access the untapped market for home loans in South Africa which the banks have judged as being too risky for direct supply.

Lease option

The lease option theoretically requires a shorter-term commitment, as the lease period is relatively shorter. Two factors, however, suggest the need for a longer-term commitment. First, developers may need to provide aspirant buyers who require more time to improve their credit records with longer leases. Second, sustaining the economies of scale required to run leases efficiently will require a succession of new leases to come on stream as the old ones expire. The length of involvement may also be determined by the form of ownership in the ownership period. An instalment arrangement and/or sectional title arrangement may extend the role of the developer.

SOHCO developed a unique approach to sustaining administrative economies of scale over time and managing or at least diversifying risk by mixing lease purchase units with long-term rental units in the same development.

Lessons

If government were to continue to supply subsidies for deferred ownership, given the long horizons required, it should only provide subsidies to companies who have a long-term commitment to the sector and the capacity to sustain themselves over the medium- to long-term.

All developers require a diversity of funding sources that can be mobilised over extended time periods.

h) Partnering/relationships with municipalities and the waiving of government rules and procedures

The **HAB** and the **CTCHC** case studies show the dangers of close involvement of the municipality in the direct running of the housing institution. It seems these housing institutions were often instructed to circumvent normal township establishment and home building procedures by municipal officials that were part of their management structure, or that procedures were not initially enforced.

It also seemed the management of subsidy finances, which was run through the municipality at the time, was also weak.

This lack of adherence to procedures initially came to haunt these projects later. Properties were made registrable comparatively late in the day, meaning that transfers were delayed. Furthermore, building quality was compromised as discussed above in 5.3.1 c).

The cost of applying rules retrospectively was also greater, especially the administrative cost for municipalities.

Lessons

The developer or housing institution should be totally separated from regulators. While it may be that regulatory requirements eventually catch up with developments, meeting the requirements causes costly delays and needs disruptive and resource intensive solutions, which are likely to undermine the sustainability of the project. If early subsidisation is to occur, only arm's-length developers should be subsidised.

i) Preserving value in medium to high density private developments with shared areas and facilities

All deferred ownership housing suppliers recognised the higher risks of economic sustainability of a project arising from a sectional title form of tenure. Ever increasing levels of neglect of the public spaces due to lack of finance arising from non-payment of maintenance levies leads to more deterioration, which in turn leads to more non-payment. Furthermore, trying to arrest the decline in levy payment pits members of the body corporate against each other and, given that members are literally required to be close neighbours and are often friends, the sanctioning of non-payment is not likely.

The sellers each had different responses to these dynamics. All **CTCHP** projects were developed as collections of freehold units, although they often had housing complex or housing estate arrangements. The HSRC report found that at least in Harmony Village, the buyers felt that the public areas serviced by the municipality were neglected, although it is not clear how they compared with surrounding areas not built with a housing estate layout. More research is required to check whether the municipality provides fewer services to these areas because they look like housing estates and/or originated in Institutional Housing Projects.

AN, with its medium-density layout, could only be managed through a sectional title arrangement. AN recognised the need for the body corporate, when established, to raise levies. Part of the reason for charging the nominal rent in the leasing phase (R400), besides funding operations and maintenance during the leasing stage, was to prepare residents for paying levies. The failure to raise the rent required is a good illustration of the domino effect problem mentioned above, as levy payment rates steadily declined.

SOHCO's strategy is to build and maintain the viability of body corporates and to retain control of these bodies, or at least to have a strong influence over them, over the course of the sales period. The concern over the efficacy of body corporates was one of the key reasons that SOHCO lowered its initial targets for institutional housing units and created a development in which lease option units are mixed with long-term rental units, as far as possible. SOHCO "sectionalised" the development very deliberately to create body corporates of an optimal size for operation, but also to enable SOHCO to gain membership of the body corporate to exercise a controlling, or at least influential, vote. The strategy has reportedly been successful.

Chartwell's approach to building body corporate viability is quite different and has evolved over a relatively short period. In its investment projects, Chartwell started out by encouraging instalment buyers to participate in body corporates without being full members, as they were not the owners of the units. For Chartwell, this created an awkward situation on body corporates where buyers expected participation without real power. In response, Chartwell, as the owner of the units, gave the instalment buyers full membership of the body corporate. The approach has been running for at least the last 2 years and appears to be working. When asked about the thinking behind the approach, Chartwell listed three factors that they thought contributed to its success: i) the management agent is appointed initially by Chartwell and helps to instil a sense of the management issues and good practices, ii) buyers receive training on the role of body corporates and the importance of levies in maintaining and increasing the capital value of units, and iii) there is a critical mass of people in the body corporate who understand the importance of levies for the upkeep of the development and the value of the units.

Before buying units for resale in sectional title schemes, **Sentinel** undertakes due diligence to assess any risks by checking the most recent AGM minutes and financial statements of the body corporate.

Lessons

Where developments make use of sectional title, the health of the body corporate is central to preserving the capital value of the units. Buyers need to be brought into this understanding.

Checking whether buyers can afford body corporate levies should be part of the screening process for selecting beneficiaries.

In projects where beneficiaries cannot afford levies, other measures may be required to bring in additional revenue for upkeep, such as a mixing of ownership units with long-term rental units or a diversity of financial sources for maintenance funding, e.g. levy and rental income.

6 CONCLUSION: ANSWERING RESEARCH QUESTIONS & DEFINING THE EMERGING SUBSIDY FRAMEWORK

The main research question investigated in this paper is whether government funded housing subsidies should be directed towards the "early" funding of deferred ownership transactions between sellers and buyers. Currently the FLISP subsidy can be used to subsidise deferred ownership, but only at the point when the deferred ownership arrangement is converted into one in which the buyer takes full ownership of the property. Early subsidisation in this report refers to subsidisation of the transaction at a point in time significantly before when the buyer takes full transfer, while late subsidisation occurs at the point of property transfer.

Four broad sub-questions were identified in the outset of this research project and are explained in Chapter 1. In this concluding chapter, we answer these sub-questions each in turn (see sections a) to d) below) based on the understanding gleaned through the research process and the evidence collected from the case studies – real life projects and initiatives that have been undertaken in the South African context.

Given the time constraints for the research and lack of pre-existing secondary materials covering deferred ownership in South Africa, methodologies for gathering information rapidly were deployed. Certain caveats and lacunas have resulted, especially in the areas of financial performance, where detailed information is required for more rigorous work. Even though the case studies undertaken were quite high-level in nature, they have proven time consuming, and have required repeated checking back with informants as new facts have emerged. In addition, there was insufficient time to extend case studies into all types of deferred ownership enterprises and initiatives. We refer to these gaps in the conclusion, indicating how they may influence the findings.

Our answers are also based on a survey of key aspects of the regulatory framework covering deferred ownership. The framework is extensive, and we have largely looked at the consumer protection aspects. The regulatory framework for specific mechanisms not covered by bespoke legislation were not explored here, e.g. lease option agreements. Such explanation requires specialist legal knowledge. The gap will be addressed in future research.

At the end of this chapter we consider what the responses to the research questions suggest about the framework for early subsidisation. Our suggestions are formulated as recommendations for policy and further policy research.

Answering the research question

a) Does deferred ownership have distinct benefits over outright sale?

In South Africa, several benefits of deferred ownership identified in the literature only arise in quite a muted way, and only in certain circumstances. Table 8 summarises the evidence suggested by the case studies against the benefits of deferred ownership claimed in the literature.

Table 8: What the South African experience suggests about realising deferred benefits

Benefit identified in literature	Evidence in SA from research
Allows greater access of mortgage-type private finance into traditionally riskier submarkets and lowers the average cost of housing finance	**Subsidy:** access is driven by a range of government subsidies, including housing subsidies and state provided concessionary finance, and a range of more hidden subsidies; some evidence of mortgage finance penetration in the post-option stage or as the instalment loan matures. **Private:** some emerging evidence for the upper-gap market and higher; access also provided for private foreign "socially responsible" investment.
Lease period creates space to improve credit readiness	**Subsidy:** some evidence in one project (SOHCO), but bank risk may have been lowered by relatively low selling prices, high market value of units and economies of scale for local bank branches. **Private:** not clear for the gap market (research not undertaken in this report).
Reduction of fees for buyers compared to the fees related to a mortgage-financed sale	**Subsidy:** Buyer fees are generally limited (with additional costs due to poorly planned property transfer processes having to be absorbed by the seller); output VAT is charged to the buyer. **Private:** Upfront fees are likely to be reduced where new build property is bought in bulk by the seller and sold in instalments and developer finance is not mortgage based, but property transfer fees could be passed on through price mark-ups. In addition, there may be post loan transaction fees in some cases (i.e. transfer fees). Significant output VAT is charged to the buyer where new build units are sold in instalments. For secondary market resales with underlying mortgage finance, very similar fees to those in mortgage sales are likely to be passed onto the buyer upfront.
Capital gains occur over instalment or lease period for the buyer	**Subsidy:** some evidence of capital gain, but seems to be reliant on size of subsidies and quality of build (and to some extent on property market performance). **Private:** Not clear at present because track record of new generation instalment sales is limited. May be heavily reliant on market performance. Not clear for lease option (research not undertaken).

Subsidy projects

The subsidy projects studied have drawn their non-subsidy developer finance requirements from government development finance and donor funding. In the limited cases where subsidy projects have been successful, buyers have been able to access private finance aimed at the mortgage market in cases where subsidies and/or donations have been high, and the ratio between selling price and market value has been low. These circumstances are not easily replicable.

In the one successful lease option project studied (SOHCO), successful completion of the lease period is very likely to have been a factor in the banks' considerations of mortgage loan applications. SOHCO reported that access to mortgage loans only increased after it became clear to local bank branches that scale economies for these types of applications were possible, and that the price value ratio for the properties was low.

There does seem to be a reduction in upfront transaction cost fees in subsidy projects. In one of the biggest sets of instalment sales projects (CTCHC projects), no upfront cost other than a deposit of around 4% of the loan amount are provided for in ISAs. The costs of mortgage registration, a requirement of the NHFC in the later projects, have been minimised by registration against the mother erf, and not directly passed on to buyers. However, over the years CTCHC has incurred property related transaction costs that it did not anticipate and which it has not been able to factor into the price of the unit, or charge buyers for. CTCHC has managed to keep property transfer fees when the buyer takes transfer of unit to a minimum. It is not clear how the CTCHC has financed these omissions and reduced fees.

Although there are no upfront payments required to gain access to units in the subsidised lease option project studied, the normal transaction costs required for mortgage financed sale (transfer and bond registration fees) are for the buyer's account and can be covered in the mortgage loan.

Where deferred ownership projects have been sustained, capital gains for the buyers are likely. More investigation is required for the early CTCHC's Legacy Projects.

Private initiatives

There is some evidence, within the Sentinel case study, that some banks are making use of the deferred ownership arrangements to invest mortgage-related finance into markets they would normally consider risky. Sentinel has secured a facility with a bank that it is able to draw on to make property purchases for on-sale by instalment loans. The draw-downs are secured by mortgages against the properties purchased by Sentinel in favour of the bank. Chartwell, another private company, on the other hand, finances its purchases through an investment loan from a foreign pension fund.

The claim that transaction related fees are minimised in deferred ownership transactions appears not to be borne out in the South African experience. Sentinel's philosophy is that an instalment sale should resemble a mortgage sale as far as possible, and its model of purchasing secondary units for on-sale generates mortgage related transaction fees, which are then passed on to buyers. As part of its simulation, Sentinel does not expect its buyer to pay two sets of transfer fees and covers the second transfer when the instalment sales agreement comes to an end. As Sentinel at present only deals in secondary market units, the value added is limited and net VAT payments to SARS are small.

Chartwell reduces its upfront transaction costs for buyers through its bulk purchase approach and internalises the costs into its sales prices. Because its developer finance is not secured by mortgages against the properties bought, Chartwell is also able to avoid bond registration costs. However, Chartwell deals in new property and thus output VAT is substantial and is included in the sales prices.

Financing costs for the VAT payments, which ultimately are paid by the buyer, are lowered as far as possible by charging VAT incrementally on only the capital payment of each instalment, by arrangement with SARS.

It is not yet clear that instalment buyers in private schemes will experience any capital gains. The projects and initiatives in this current generation are still too new.

b) Can the risks of deferred ownership generally be managed?

Chapter 5 of this report gives an account of the way that the risks identified in Chapter 2 have been managed in the cases studied in the report and what lessons for practice in South Africa arise from this analysis. The studies show that overall, the risks in several deferred ownership arrangements can be managed with sufficient effort. Certain types of arrangements, however, are too risky and should be avoided altogether.

It is also important for subsidy providers to understand what experience implies about whether these risks can be addressed and whether sellers do, in fact, address them properly. If subsidies are applied to projects in which the risks are not adequately managed, the type of subsidy leakage identified in Chapter 2 is very likely to be significant.

Buyer capital risks

South Africa has a relatively comprehensive and effective set of regulations offering protection to instalment sales buyers, including chapter 2 of the ALA, which is specifically designed for instalment sales. All sellers, including subsidised sellers, should follow the regulations. Recording the ISA in the Deeds Office, and ensuring the property is registerable early in the ISA, are key requirements that should be strictly followed. The NCA is also key and requires that sellers only extend loans to would-be buyers who can afford to service them and have proven credit records and thus the measures help to prevent short-term exploitation by lenders through the payments of high interest rates and fees of entry before the loan is cancelled.

While there are good regulations in the ALA, they are not well known by the role players: buyers, sellers and the lower courts. Risk management will improve with greater understanding. Government and the banks can be tasked with creating this understanding.

We could not ascertain to what extent South African regulation addresses buyer risks within lease option arrangements during the leasing period. More specialised legal research is required here. The international literature points to substantial buyer risk during the lease period, as buyers appear to have limited rights, because they are not paying off capital during the lease period and can thus make no claim to ownership rights.

Risks of non-payment

Non-payment by buyers or lessees appears to be a significant risk in subsidised deferred ownership projects. All these projects studied are arm's-length projects. Overall, in the sector affected, non-payment has been so severe that the NHFC, the DFI which provided concessionary loan finance to nearly all projects, has suffered significant losses and has withdrawn from funding Institutional Housing projects.

The projects which reportedly showed good to better payment collections attracted substantial subsidies in addition to the Institutional Subsidy, had taken special measures to address buyer perceptions of building quality and experienced increases in property values. The exception was AN, which experienced significant non-payment. AN is a lease option project which drew lessees from a small geographic community. It put in place no real alternative for qualifiers not wishing to be part of the project and excluded a significant part of the community, as they did not qualify for the subsidy. Some of the better performing projects were more rigorous in the way they selected buyers.

"Political interference" appears to be a key factor in non-payment, and subsidy projects seem to be particularly susceptible. Perceptions of poor building quality often seemed to provide a pretext for political interference. Subsidised sellers reported that they struggled with managing this risk, given the contagion effect of even a small group of non-payers. SOHCO's success was based on forming a relationship with a residents' committee and trying to address the concerns of members wherever this was practical. This approach requires strong commitment to lengthy engagement, which is not always possible for sellers, especially when they are unable to gain support from influential local politicians.

The privately funded projects seem to have limited problems with non-payment. Their better performance probably relates in great part to the higher income market they serve: the upper-gap and beyond. Experience has also shown that buyer selection is critical, and that payment default needs to be clearly defined in the loan agreement and acted upon swiftly by the seller. Private sellers have also emphasised the importance of the provision of a **"dignified exit"** mechanism for buyers who, for whatever reason, prefer to leave the scheme. Allowing these buyers to exit easily helps to address non-payment problems. Dignified exit allows buyers to recover their capital contributions in a low-cost fashion and gives sellers a way of recovering payment arrears and the capital owing to them.

Seller capital risks

A key risk for sellers arises from the tenure arrangements under which the property is sold, which can strongly impact on the capital value of the property. At stake is the management and upkeep of shared spaces surrounding strictly privately held property, for example the shared spaces in sectional title schemes. These arrangements also give rise to capital risks for buyers. Sellers have developed a range of strategies. One strategy is to mix sectional title and long-term rental tenures to lower dependence on levies to fund maintenance in schemes. Sellers have also ensured that buyers can afford levies at the time of approving buyers for the scheme (i.e. during selection). A third strategy is to insert instalment buyers into responsibility as full members of the body corporate, providing them with initial training and then linking them up with a good management agency.

Building quality risks

There are several avenues related to the direct oversight of the construction process for addressing the risk of poor building quality in housing projects. The CPA also incentivises good quality through establishing an implied warranty on property sold by instalment sales providers. The sellers should make use of all these measures, including facilitating the various levels of building inspectors (at municipal level and within the NHBRC) to oversee the construction process.

An important basic measure for ensuring good building quality, especially where the buyer receives a subsidy, is to give the buyer a strong choice over the unit purchased via the subsidy. That is, to mimic a normal commercial property transaction, consumer choice is strongest where the consumer can examine the product before purchase. The scheme that allows for this choice will also ensure that purchases being subsidised are for units which are, in fact, built and registerable.

Seller costs and overheads risks

Given that deferred ownership arrangements usually entail a relatively long relationship between the seller and buyer, and that those relationships can be of variable length, sellers need to be constantly growing their books and have a diversity of funding sources.

According to the ALA, the buyers are liable for the payment of property rates and service charges associated with the properties. However, municipalities are reluctant to recover these payments directly from individual buyers and see sellers as liable. In new developments, municipalities do not value properties separately, which makes the valuing of estates very difficult. Sellers are essentially forced to include the charges in the monthly levies for which the buyer is billed. These charges increase the collection and administrative burden of sellers and raise the size of monthly payments they collect which could increase the risk of payment default.

The municipality needs to be clear about its property rates and service charge billing policy, which needs to be stable and implemented in a consistent manner. Municipal finance oversight bodies and housing authorities should monitor these aspects of policy. Any gaps in national policy and provincial policy should be addressed.

Regulatory risks for sellers

Sellers mentioned risks related to the way the courts understand and interpret the regulatory measures affecting deferred ownership. Sellers can address some of these risks by following regulations to the letter as far as possible. Creating awareness of the legal provisions amongst key role players, as mentioned above, is also an important factor.

c) Should projects and initiatives take a direct supply form, or should the arm's-length form be retained as the only form?

No examples of deferred ownership schemes in which a government seller directly supplies units have been found in the South African context. This lack may be due to regulatory hurdles for government sellers (i.e. loan providers), mentioned in section 3.5 above, that require clearing.

The lack of direct supply is also surely due to the non-payment dangers that the government perceives is inherent in such an arrangement. If non-payment is a significant problem, even in arm's-length subsidised projects, how much more of a problem will it be in directly run projects? Rental schemes run directly by the government show chronically low collection rates that have persisted for some time, despite strong efforts to improve building quality. Collection rates for rental properties owned and managed by the City of Cape Town lie between 18% and 30%.

Recovery rates at similar levels in deferred ownership schemes will mean that government will not be able to recover construction and operating subsidies locked into these schemes for higher priority subsidy programmes. Operating deficits at such a scale will have negative financial, environmental and governance consequences for host municipalities, and undermine fairness in the subsidy system, as a minority of gap market households capture significant subsidies.

By comparison, privately run rental schemes show much better recovery rates, suggesting arm's-length approaches would be much more sustainable.

d) At what point in the deferred ownership project cycle should an early subsidy occur?

The Institutional Subsidy case studies suggest that there are several significant dangers in providing subsidies as developer finance to partially fund the construction of units for sale via deferred ownership mechanisms. Units of low quality may be constructed that beneficiaries approved before construction and then feel obliged to occupy, as the only alternative is to give up their subsidy and continue to wait for other opportunities. Non-payment problems usually arise in these circumstances. The problem will be compounded if the township establishment process is not complete and the property is not registrable.

An effective way of addressing these risks is to provide the subsidy only after the unit is built, and has been assessed for quality, and the property is proven registrable. In such a context, the subsidy can be provided in a manner like the FLISP, i.e. a capital payment into the buyer's loan account, albeit an instalment loan account.

Such subsidy payments cannot occur in a lease option arrangement, as the aspirant buyer does not have a housing loan account during the lease period. Given our current understanding of the high risks that are faced by buyers in the leasing period, it would make sense to only approve and release the subsidy once the lease period is over. Such an approach is also consistent with viewing the lease period as one in which an aspirant buyer can improve their credit position to better access finance and exercise their option to purchase.

6.2 Recommendations: An emerging framework for early subsidisation

The responses to the research questions laid out above begin to suggest a set of recommendations for early subsidisation from which a subsidy framework can be constructed. We formulate these recommendations as actions:

- retain the arm's-length approach to subsidising deferred ownership units to avoid catastrophic non-payment risk, i.e. government refrains from being a direct seller
- facilitate compliance to all consumer protection legislation, including the ALA
- recognise emerging new private companies providing instalment sale loans in their own developments or for properties they have purchased as a building block for new subsidisation policy, rather than forming new housing institutions
- investigate providing FLISP subsidies to buyers purchasing properties from these new companies only at the point that the physical unit is available and registerable. The investigation should be done as part of considering extending the FLISP subsidy into a range of non-mortgage loans, e.g. pension-backed loans. Subsidies should be provided subject to due diligence checks on the companies and their housing and loan products.
- do not provide early subsidies for lease option during the lease period, as the lease period is a test period to improve the creditworthiness of the aspirant buyer and appears to hold significant risk for the aspirant buyer. In other words, no support by the Department should be given to lease option schemes up until the point where beneficiaries are able to secure a mortgage or other finance to purchase the property. There are also practical constraints regarding the funding mechanism if the seller rather than the buyer is to be subsidised.
- explore a range of mechanisms for improving creditworthiness and signalling improvements other than through a lease option, given the dangers the lease option appears to hold for the aspirant buyer. For instance, long-term landlords can be encouraged to report on-time payments by lessees to credit bureaus, offer longer-term leases, and give tenants the right of first refusal should they sell the rental unit.
- retain the current FLISP arrangements for late subsidy of deferred ownership, i.e. FLISP approval and payment at the point of transfer into full ownership. Late subsidisation of deferred ownership agreements carries the same risk as subsidising mortgage-financed sales, which is widely seen as acceptable.

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