

# Research Report

## Consolidated analysis of research into Small Scale Landlords and Home Based Entrepreneurs

A research project sponsored by the National Department of Housing, the Social Housing Foundation, Nedbank and the FinMark Trust

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### Final Report

**Date: April 2006**

**Submitted by:**

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**in Association with CSIR Built Environment**

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**This research into Housing Entrepreneurs has been undertaken by Shisaka Development Management Services (Pty) Ltd in association with CSIR Built Environment**

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## **Reports produced as part of the Housing Entrepreneurs Research Project:**

### **Final Reports:**

**Research Report:** Consolidated analysis of research into Small Scale Landlords and Home Based Entrepreneurs (April 2006)

**Small Scale Landlords:** Research Findings and Recommendations (3 May 2006)

**Home Based Entrepreneurs:** Research Findings and Recommendations (to be released in July 2006)

### **Resource Reports**

#### **Literature Review**

**Resource Report 1:** Literature review of Small Scale Landlords (6 February 2006)

**Resource Report 2:** Literature review on the financial needs and products available to Small Scale Landlords and Entrepreneurs from Commercial Banks. (6 February 2006)

**Resource Report 3:** Literature review on entrepreneurship, housing and housing finance (6 February 2006)

**Resource Report 4:** Literature review on Home Based Entrepreneurs (6 February 2006)

#### **Small Scale Landlords**

**Resource Report 5:** Research into Landlords in Inner Cities (6 February 2006)

**Resource Report 6:** Research into Landlords in Townships (6 February 2006)

**Resource Report 7:** Research into Successful Landlords (6 February 2006)

**Resource Report 8:** Research into Service Providers in respect of Small Scale Landlords (6 February 2006)

**Resource Report 9:** Research into Public Sector Stock (6 February 2006)

#### **Home Based Entrepreneurs**

**Resource Report 10:** Research into Home Based Entrepreneurs (6 February 2006)

**Resource Report 11:** Research into Successful Entrepreneurs (6 February 2006)

**Resource Report 12:** Research into Service Providers in respect of Entrepreneurs (6 February 2006)

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# 1 Introduction

## 1.1 Rationale for the research

Since the formation of the Government of National Unity in 1994, there have been significant strides towards the transformation of the lives of ordinary South Africans. Set within a macroeconomic policy, which is focused on stimulating economic growth, there has been **significant delivery** in respect of the provision of housing, engineering services such as water and electricity and social services such as education, health and social safety nets for the most vulnerable. A significant portion of Government annual expenditure continues to be directed to meeting these needs.

Yet despite these efforts by Government, **poverty has increased**<sup>1</sup>. The South Africa, Human Development Report (2003)<sup>2</sup> indicates that **48,5% of the South African population (21,9million people)** fall below the national poverty line<sup>3</sup>. In addition poverty has a highly skewed gender, race and spatial profile with the majority of the poor being female, African and living in rural areas.

**Unemployment continues to be a significant problem.** While important strides have been made in overcoming the past inequalities in the labour market, employment opportunities remain low. Unemployment is currently assessed as being 26%<sup>4</sup>. This is considerably better than the **31,2%** (in terms of the strict definition) or **41,8%** (in terms of the expanded definition)<sup>5</sup> estimated in 2003, but is still extremely high. Government has set a target to reduce unemployment to below 15% and halve the poverty rate by 2010.<sup>6</sup>

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<sup>1</sup> It is noted that there are a number of different statistics and measures on poverty and there is currently no official definition of the term. The statistics quoted in this paragraph are therefore indicative only to highlight the severity of this issue.

<sup>2</sup> South Africa, Human Development Report 2003, Published for the United Nations Development Programme, Oxford University Press, 2003

<sup>3</sup> The poverty line is R354 per month per adult

<sup>4</sup> Media briefing by Deputy President Phumzile Mlanbo-Ngcuka, 6 February 2006, Background document, A catalyst for Accelerated and shared Growth-South Africa

<sup>5</sup> The strict definition includes only individuals who are actively seeking work. The broad definition includes young entrants and discouraged workers who are individuals who have stopped looking as they have lost hope. Figures quoted are from South Africa, Human Development Report 2003.

<sup>6</sup> Media briefing by Deputy President Phumzile Mlanbo-Ngcuka, 6 February 2006, Background document, A catalyst for Accelerated and shared Growth-South Africa

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Addressing poverty, unemployment and service delivery has increasingly become a **central theme and focus** of all stakeholders both within the public and private sectors. Initiatives being undertaken range from high level macroeconomic interventions to small scale community based programmes. One of the critical elements identified is that of **promoting small and medium sized enterprises** (SMME's).

In his **State of the Nation Address given on the 3 February 2006, Thabo Mbeki said:**

*“We should move faster to address the challenges of poverty, underdevelopment and marginalisation confronting those caught within the Second Economy, to ensure that the poor in our country share in our growing prosperity.....  
ASGISA has once more confirmed the need for us to expand our small, medium and micro enterprise (SMME) sector, paying particular attention in this regard to Broad-Based Black Economic Empowerment, and the development of women and the youth”.*

This research seeks to contribute to addressing these fundamental issues **by obtaining a deeper understanding of housing as a productive asset and its role in promoting economic activity and improved affordable housing supply**, through supporting the activities of **Home Based Entrepreneurs and Small Scale Landlords**.

The Labour Force Survey for 2002 indicates that 53% of households (5,63 million) in South Africa own their house. For these households their **house offers opportunities for wealth creation** in that:

- It can be **used to create capital** as the house can be used to leverage capital (currently through obtaining mortgage finance) or through selling the house and using the finance to establish or expand a business, or
- To **generate income** by either offering accommodation for rent (Landlord) or operating a business from the property (Home Based Enterprise).

Research undertaken by Finmark in 2004 into the Workings of Township Residential Property Markets found that the estimated value of residential properties in Black Townships in South Africa was R68,3 billion. Nevertheless the **use of these properties for wealth creation and or income generation is extremely limited**.

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By and large households are unable or unwilling to leverage capital using their property as an asset and are not making use of such property to generate income, either through rental or the use of the property for business purposes. Other research particularly that undertaken by Nurcha also in 2004 however **found viable rental markets, in low income areas**, where backyard rental is being used as a productive asset and providing affordable housing options to the poor.

**Accordingly this study poses the question as to how housing finance can be used to increase the extent to which Landlords and Home Based Entrepreneurs use their housing asset productively and contribute to affordable housing supply in South Africa.**

## *1.2 Conceptual approach*

The research focused on obtaining a detailed understanding of how **Small Scale Landlords** and **Home Based Entrepreneurs** (see Section 2.2 for a definition of these terms) operate, the key constraints that they face and the extent to which they are using their home as a productive asset. This was set within the context of obtaining **a broad understanding of entrepreneurship** and current policy and practice in unleashing and supporting entrepreneurial activity.

While the research focused on addressing the key research questions that had been asked by the Funders of the research (see Section 1.3 below), it also sought to address the following questions:

- How can the **rental housing sector be stimulated so as to increase the amount of rental stock available to low income households**, as well as **improve the quality of stock that is already available**?
- How can Entrepreneurs be assisted to **start new businesses or grow existing business through the use of their housing asset** thereby assisting in income generation and wealth creation and overall economic development within South Africa?

Figure 1 below provides an overview of the conceptual approach underpinning the research.

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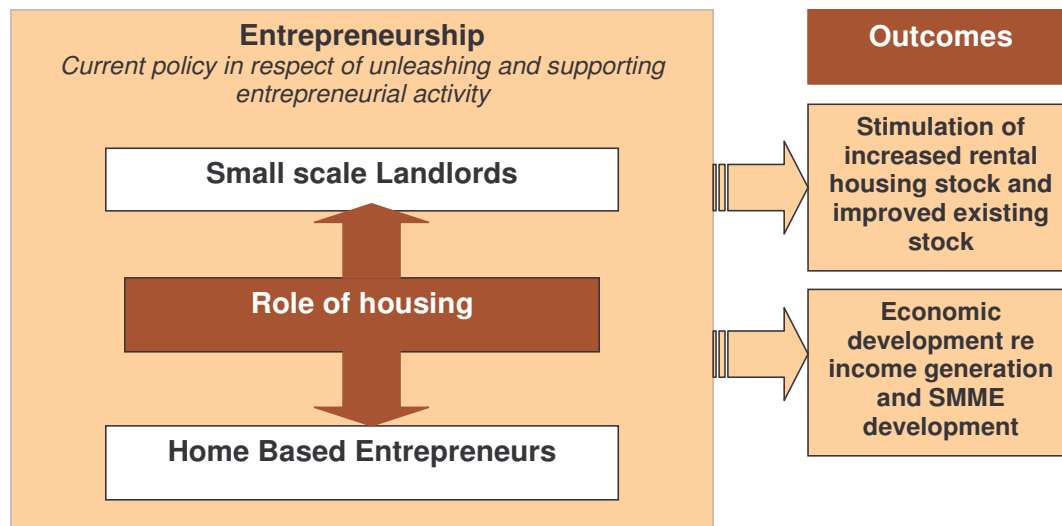


Figure 1: Conceptual approach of the research

### 1.3 Purpose of the research

The research is funded by Finmark Trust, the Social Housing Foundation, Nedbank, the Gauteng Department of Housing and the National Department of Housing who appointed Shisaka Development Management Services in association with the CSIR to undertake the research.

The purpose of the research is to understand **how housing and housing finance can be used as a tool to promote the emergence and growth of entrepreneurs and small scale landlords**. Specifically the study aims at:

- **Identifying the housing finance interventions** necessary to build an entrepreneurial and small scale landlord sector in low income areas.
- Developing **appropriate information products and tools** to assist emerging entrepreneurs and landlords in their efforts at becoming housing entrepreneurs.
- Focusing on the potential for small scale entrepreneur landlords to be the model for dealing with **difficult to transfer state owned stock**.
- Understanding the key issues which would support a **productive relationship between the landlord and the tenant** in the small scale sector in the mutual interests of both parties.

- Inform policy and strategy directions so as to facilitate **better access to housing investment opportunities for either entrepreneurs or small scale landlords**, such as are already being realised in the middle and upper income sector of South Africa.

### 1.4 Overall methodology

The methodology applied in undertaking the research comprises five phases. The first phase (which is the subject matter of this report) consists of extensive primary and secondary research into landlords, entrepreneurs, lenders and other service providers. Figure 2 below shows the methodology.

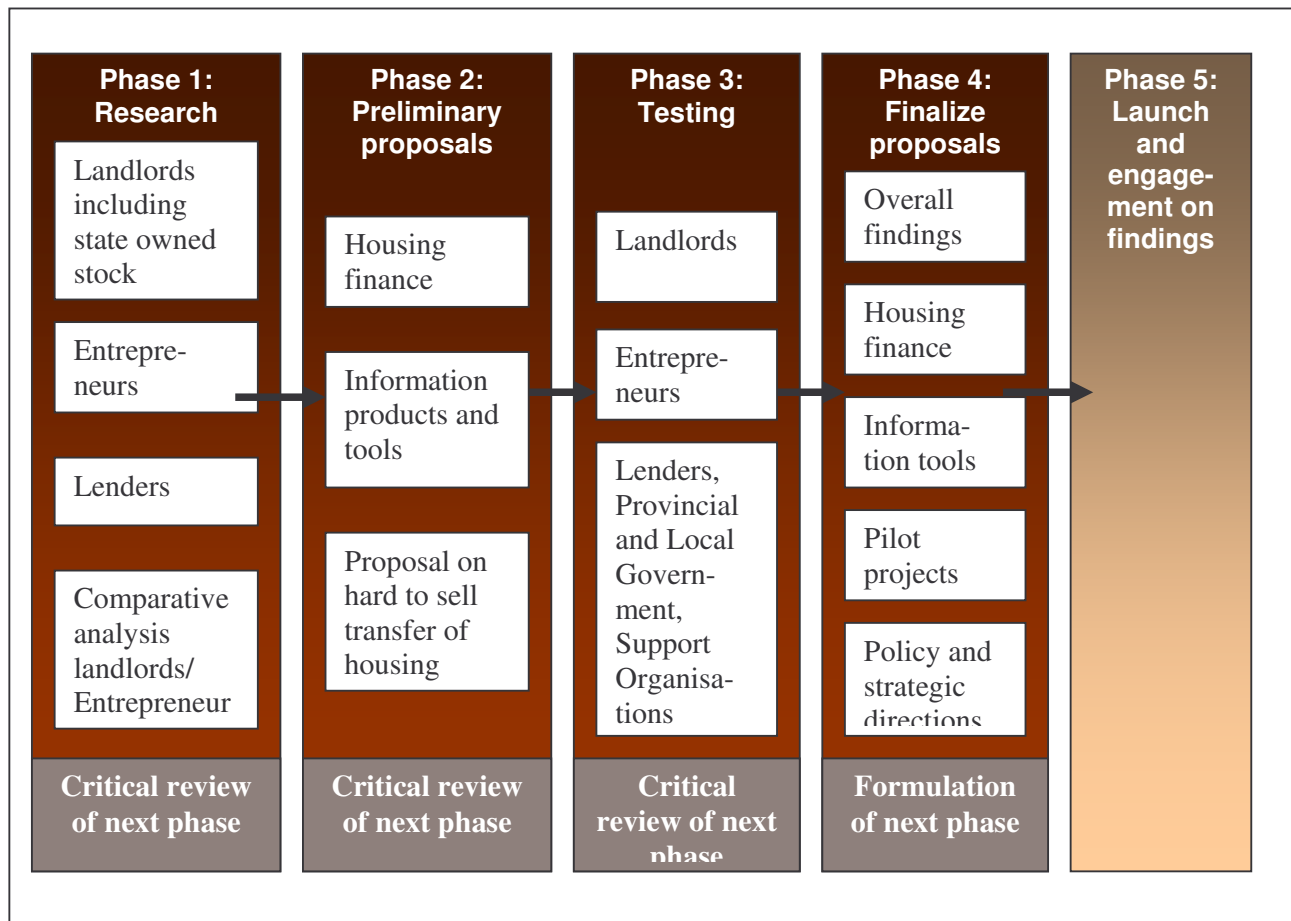


Figure 2: Overall methodology

In applying the above methodology the following underlying principles were adopted:

- While it is recognised that **Entrepreneurs and Small Scale Landlords are both undertaking entrepreneurial activity, they are different**, operating in different markets and regulatory frameworks and using the house as a productive asset differently. In addition the availability of research material in respect of each of these target groupings differs. Accordingly research and the formulation of proposals with respect to each of these groupings is undertaken separately and structured differently for each group. In order to determine if similarities exist between these two different target groupings, comparative analysis was undertaken during the research.
- **There has been extensive research undertaken** into landlords and tenants and rental accommodation. Accordingly the approach adopted was to make use as much as possible of the existing research and only undertake primary research where none exists.
- **This assignment seeks to develop practical applications in the form of products and tools**, which will enhance the performance of Housing Entrepreneurs. Consequently the methodology provides for an iterative approach of research informing the development of proposals. The proposals then in turn form the basis for engagement and testing with the target groupings and their support organizations.

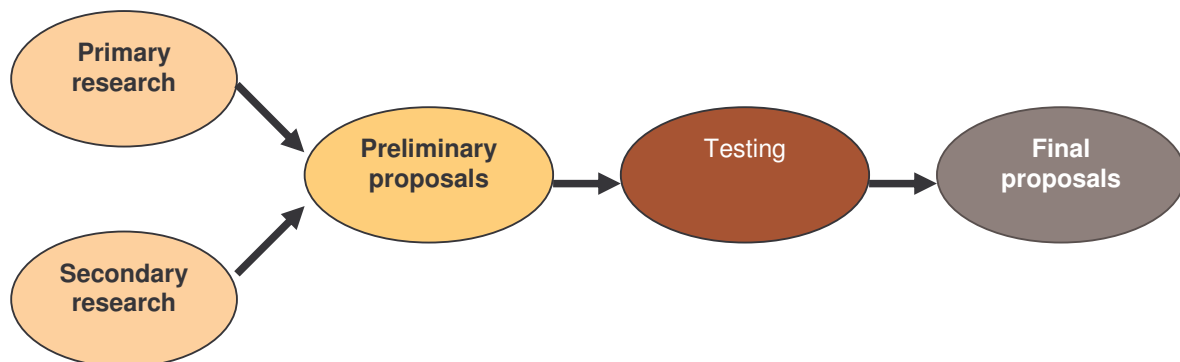


Figure 3: Methodological approach adopted

- **The work being undertaken is exploratory in nature:** The work undertaken is highly exploratory in nature resulting in the defining of new terminology and concepts. In addition the findings of each phase were used to critically review the proposed basis on which the next phase was to be undertaken, so as not to rigidly pursue a pre-agreed methodology irrespective of what is learnt.
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### ***1.5 Overview of report***

**This report provides an overview of the research undertaken and findings of Phase 1 of the research and includes:**

- Methodology of Phase 1
- Overview of the research undertaken in terms of :
  - Research into Small Scale Landlords
  - Research into Home Based Entrepreneurs
- Overall conclusions

## 2 Methodology of Phase 1: Research

### 2.1 Components of Phase 1

Phase 1 comprised undertaking research into the following focus areas:

- Small Scale Landlords
- Home Based Entrepreneurs

The research undertaken included the following:

- **Literature reviews** : Four literature reviews were undertaken in respect of the following areas:
  - Small Scale Landlords
  - Financial needs and products available to Small Scale Landlords and Entrepreneurs from Commercial Banks.
  - Entrepreneurship, housing and housing finance
  - Home Based Entrepreneurs

International and national literature was reviewed through an Internet search, as well as documentation already assembled by the Team.

- **Research into Small Scale Landlords:** This research included the following:
  - **Survey of Small Scale Landlords in Inner Cities:** This research comprised primary research into Landlords operating in two inner city areas (Hillbrow/Berea in Johannesburg and Sunnyside/Tshwane Central in Pretoria). A total of:
    - 237 Landlords were interviewed of which 91 Landlords were interviewed in Tshwane and 146 in Johannesburg, and
    - 125 Tenants were interviewed of which 50 were in Tshwane and 75 in Johannesburg.
  - **Research into Small Scale Landlords in Townships:** Due to the fact that Nurcha had undertaken extensive research into Landlords in Townships in 2003, it was decided to make use of the research that already exists rather than undertake primary research. The research undertaken by Nurcha focused on three areas namely **Orlando East** in Soweto, Gauteng, **Katorus** in South East of Johannesburg, Gauteng and **Cato Manor**

in Durban, KwaZulu Natal<sup>7</sup>. The size of the sample researched was **400 landlords** each in Orlando East and Katorus and **291** in Cato Manor.

The review and detailed analysis of the Nurcha data was complemented by four focus groups, two of tenants and two of Landlords, undertaken as part of the study, to test some of the key issues pertaining to the study and not covered in the Nurcha data.

- **Interviews with Successful Landlords:** This research comprised qualitative in-depth interviews with 20 Landlords perceived as being ‘successful’.
- **Interviews with Service Providers in respect of Small Scale Landlords:** This research comprised qualitative in-depth interviews with Service Providers (including Lenders) providing services to Small Scale Landlords. A total of 7 individuals were interviewed.
- **Research into Public Sector Stock:** This research comprised a review of the current status and availability of Public Sector stock and the issues pertaining to the transfer of such stock to determine the feasibility of applying an approach whereby such stock is transferred to Small Scale Landlords. As part of this research two case studies were reviewed.
- **Research into Home Based Entrepreneurs:** This research included the following
  - **Survey of Home Based Entrepreneurs in Inner Cities:** This research comprised primary research into Home Based Entrepreneurs operating in two inner city areas. The two inner city areas selected were the same as for the research into Small Scale Landlords namely (Hillbrow/Berea in Johannesburg and Sunnyside/Tshwane Central in Pretoria). A total of 140 Home Based Entrepreneurs were interviewed (70 in each area).
  - **Survey of Home Based Entrepreneurs in Townships:** This research comprised primary research into Home Based Entrepreneurs operating in three township areas.. The three township areas selected were Orlando East, Mamelodi and Katlehong. A total number of 210 Entrepreneurs were interviewed (70 in each area).
  - **Interviews with Successful Entrepreneurs:** This research comprised qualitative in-depth interviews with 20 Entrepreneurs perceived as being ‘successful’.

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<sup>7</sup> Despite the fact that all of the primary research undertaken in terms of the research into Small Scale Landlords was Gauteng based, Cato Manor was included as it formed part of the Nurcha research.

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- **Interviews with Service Providers and Lenders in respect of Entrepreneurs:** This research comprised qualitative in-depth interviews with Service Providers and Lenders providing services to Entrepreneurs. A total of 5 individuals were interviewed.

Table 1 below provides a summary of the components of the Phase 1 research. Details on the methodology applied in respect of each component of the research are set out in separate Resource Reports that have been developed in respect of each component (as detailed below).

Table 1 Components of Phase 1: Research

	<b>Small Scale Landlords</b>	<b>Entrepreneurs</b>
Literature reviews	<b>Small Scale Landlords</b>	<b>Entrepreneurship; Home Based Entrepreneurs</b>
	<b>Lending products linked to housing finance</b>	
Township	<b>Desk study using Nurcha research</b> (Katorus (400), Orlando East (400), Cato Manor (291)) <b>4 focus groups</b>	<b>Three townships</b> (Katlhong, Orlando East, Mamelodi. Households scanned to identify entrepreneurial activity. 70 interviews undertaken with entrepreneurs in each area (210))
Inner City	<b>Two inner cities</b> (Hillbrow/Berea, Sunnyside /Pretoria Central) Scan of tenants undertaken to identify landlords 237 interviews with Landlords 125 interviews with Tenants	<b>Two inner cities</b> (Hillbrow/Berea, Sunnyside /Pretoria Central) Scan of tenants undertaken to identify entrepreneurial activity 70 interviews undertaken with entrepreneurs in each area (140)
Success stories	<b>Successful Landlords</b> Scan undertaken to identify successful landlords – 20 in-depth interviews undertaken	<b>Successful Entrepreneurs</b> Scan undertaken to identify successful entrepreneurs – 20 in-depth interviews undertaken
	<b>Public Sector Stock</b> 2 case studies reviewed	

The social survey undertaken was sampled on a basis which ensured the statistical representivity of the areas surveyed. A number of problems were experienced in undertaking the research. The most significant of these were as follows:

- The scan of tenants in Sunnyside resulted in insufficient landlords and entrepreneurs being identified, as many tenants are students or Government employees. Accordingly the sample was expanded to include Pretoria Central.



- Of the landlords identified in the inner cities, 21% were landlords that do not interact directly with tenants but use a Managing Agent or other means to interface with the tenants. Managing Agents contacted to request details of the Landlords so that they could be interviewed, however refused to disclose this information on the basis that it transgressed their Ethical Code. Deeds searches were then used to attempt to identify the Landlords but did not provide a sufficient number of Landlords. Accordingly interviews were held with the Managing Agents to obtain a broad understanding of this category of Landlord.

The research has been documented in twelve Resource Reports. These Resource Reports contain the detailed data (in respect of the primary research) and the analysis undertaken. The Resource Reports are available on request. This report comprises a summary of each Report. The Resource Reports include the following:

- **Resource Report 1:** Literature review of Small Scale Landlords
- **Resource Report 2:** Literature review on the financial needs and products available to Small Scale Landlords and Entrepreneurs from Commercial Banks.
- **Resource Report 3:** Literature review on entrepreneurship, housing and housing finance
- **Resource Report 4:** Literature review on Home Based Entrepreneurs
- **Resource Report 5:** Research into Landlords in Inner Cities
- **Resource Report 6:** Research into Landlords in Townships
- **Resource Report 7:** Research into Successful Landlords
- **Resource Report 8:** Research into Service Providers in respect of Small Scale Landlords
- **Resource Report 9:** Research into Public Sector Stock
- **Resource Report 10:** Research into Home Based Entrepreneurs
- **Resource Report 11:** Research into Successful Entrepreneurs
- **Resource Report 12:** Research into Service Providers in respect of Entrepreneurs

## 2.2 Definitions

The following definitions were assumed for the purposes of the study:

- *A Housing **Entrepreneur** is defined as an Entrepreneur who:*
  - *Generates income from his/her house by offering accommodation for rent (Landlord)*

- *Generates income from his/her house by operating a business from the property (Home Based Enterprise)*
  - *Small Scale Landlords*
    - ***Rental accommodation** refers to the consensual occupation of accommodation by an individual or individuals (lessee or tenant) controlled by another individual or institution (lessor or landlord) on an agreed basis, generally for an agreed payment. This agreement may be written (lease agreement), or verbal and generally sets out the terms on which the accommodation is rented.<sup>8</sup>*
    - *A **Landlord** is a person who has rights to a property and rents it to another person for regular payments, which may be in cash or kind (comprising either food or services).*
    - *A **Small Scale Landlord** is defined as a Landlord who rents out between 1 and 100 units or up to 3 buildings.*
    - *A '**Successful** Small Scale Landlord' is an individual/enterprise that displays one or more of the following characteristics:*
      - *The scale of operation is large whereby more than 10 units or 1 building are being offered for rental.*
      - *The enterprise consistently shows high turnover and margins (over 5% profit increase pa)*
      - *The quality of the rental stock provided is within minimum standards and is maintained on an ongoing basis.*
      - *The relationship with tenants is generally good.*
      - *The landlord is recognised by his/her peers or tenants as being successful*
      - *The enterprise/landlord has the ability to adapt to changing demand or market conditions.*
      - *The enterprise/landlord is able to deal with external environmental factors.*
  - *Home Based Entrepreneurs (HBE)*
    - *An **Entrepreneur** is a person who generates revenue through the utilisation of their own resources, as their main source of income.*
    - *A **Small Business** is defined as 'a separate and distinct business entity, including cooperative enterprises and non-governmental organisations, managed by one owner or more which, is predominantly carried on in any sector or sub sector of the economy'. Small businesses can be classified as micro, very small, small or medium*
-

enterprises. *Survivalist business* is generally defined as only providing income below the poverty line<sup>9</sup>.

- A *Home-based enterprise* is income generating activities undertaken by residents of a house, using the home as a base.
- A *'Successful' Entrepreneur* is an individual/enterprise that displays one or more of the following characteristics:
  - The scale of operation is large whereby more than 10 people are employed.
  - The enterprise consistently shows high turnover and margins (over 5% profit increase pa)
  - The enterprise has been in operation for 3 years or more.
  - The product or service provided is competitive in that the enterprise services a stable customer base.
  - The relationship with customers is generally good.
  - The enterprise diversifies in order to meet customers needs
  - The entrepreneur is recognised by his/her peers or customers as being successful
  - The enterprise has the ability to adapt to changing demand or market conditions.
  - The enterprise is able to deal with external environmental factors.

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<sup>8</sup> From Social Housing Handbook, Social Housing Foundation in South African Rental Sector Overview, David Gardner, 2005

<sup>9</sup> The National Small Business Act

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### 3 Analysis of the research undertaken

This section provides an overview and analysis of the research undertaken into Small Scale Landlords and Home Based Entrepreneurs respectively.

#### 3.1 *Small Scale Landlords*

**This section provides an overview of Small Scale Landlords and the context in which they operate** and covers:

- The rental sector in South Africa
- Extent and contribution of Small Scale Landlords
- Types of Small Scale Landlords
- Profile of Small Scale Landlords
- Stock and Operating Procedures
- Landlord Tenant Relationships
- Finance and support
- Regulations
- Public Sector Stock

This section comprises an analysis of the research undertaken and outlined in Resource Reports 1, 2, 5, 6, 7, 8 and 9.

##### 3.1.1 The rental sector in South Africa<sup>10</sup>

**Just under one third of all South Africans (3,5 million households) live in rental accommodation. While the number of households renting accommodation has increased slightly since 1999 (by 100 000 households), the rental sector has decreased in size in respect of the overall housing sector (from 31% in 1999 to 27% in 2005).**

**The rental sector can be categorised into the Formal Sub-Sector and Household Rental Sub-Sector. The Formal Sub-Sector comprises 1,5 million households or 43% of the Rental Sector. The Household Sub-Sector comprises 1,1 million households or 31% of the Rental Sector.**

**There has been an increased focus on the role of the Rental Sector in overall housing policy in the last five years and particularly on the Household Rental Sub-Sector.**

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<sup>10</sup> For more details see Resource Report 1

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Table 2 below provides an overview of the housing sector in South Africa as reflected in the October Household Survey (OHS) of 1999 and the Labour Force Survey (LFS) of 2005<sup>11</sup>.

Table 2: Overview of the rental sector as a component of the overall housing sector

Overall housing sector							
Data Source		Owned	Rented	Traditional	Informal Settlement	Other	Total
OHS 1999	No hh (mil)	5,2	3,4	1,15	1,0	0,1	10,85
	%	48	31	11	9	1	100
	Mean hh income (R pm)	3500	1600	700	1100	200	2600
LFS 2005	No hh (mil)	6,2	3,5	1,5	1,4	0,1	12,7
	%	49	27	12	11	1	100
	Mean hh income (R pm)	3900 <i>3000<sup>12</sup></i>	2900 <i>2200</i>	600 <i>500</i>	1200 <i>900</i>	1400 <i>1100</i>	2900 <i>2200</i>

Rental housing sector rental Sector				
Census		For-ma l	House- hold	Other
OHS 1999	No hh (mil)	1,6	1,0	0,8
	%	15	9	7
	Mean hh income	3200	1500	1500
LFS 2005	No hh (mil)	1,5	1,1	0,9
	%	12	9	7
	Mean hh income	4100 <i>3100</i>	1800 <i>1400</i>	2200 <i>1700</i>

#### Definition of terms

**Owned:** households who have registered title over the properties in which they live.

**Rented:** households who live in a property with consent from the owner/landlord or their agent.

**Traditional:** households living in a traditional dwelling, hut or structure made from traditional materials

**Informal Settlement:** households living in an informal dwelling on a piece of land without the consent of the owner.

**Other:** caravan, tent, ship etc

**Formal rental:** includes house or brick structure on a separate stand or yard, flat in block of flats, town/cluster/semi-detached house

**Household rental:** includes house, flat, room in back yard, informal dwelling/shack in back yard.

As detailed in the Table above it is evident that:

- The **rental sector** in 2005 comprises **27% of the overall housing sector** (3,5 million households). While the sector has increased slightly in respect of the number of households living in rented accommodation from 1999 (3,4 million households), it has

<sup>11</sup> The OHS and LFS can be compared as both samples are designed by Stats SA to be representative of the national population, and the wording of the relevant questions is virtually identical. The income figures have been adjusted for a deflation (CPI) factor of 30% to make the 2005 figures comparable with the 1999 ones.

decreased in size in respect of the overall housing sector (from 31% in 1999 to 27% in 2005).

In comparison to other components of the overall housing sector, the number of households owning a house increased over the period (significantly in respect of number of households from 5,2 million to 6,2 million (1 million households) and less so in terms of percentage size of the overall housing sector from 48% to 49%). In addition increases are seen in respect of both Traditional housing and Informal Settlements, with increases of 1,15 to 1,5 million households (350 000 households) in respect of Traditional housing and 1,0 to 1,4 million (400 000 households) in respect of Informal Settlements.

Income levels of households living in the different housing categories remain similar between 1999 and 2005 if inflation is taken into consideration, with the exception of those households living in rental accommodation, which shows higher incomes in 2005 than in 1999. This could reflect increasing costs within the rental sector.

**In respect of the Overall Housing Sector it can therefore be concluded that between the period 1999 and 2005 there has been a limited increase in the number of households living in rental accommodation. Significantly more households are living in owned accommodation. There was an increase in the number of households living in informal units including both traditional dwellings and informal settlements.**

**Incomes of households living in the different housing categories generally decreased (taking into account inflation) with the exception of the rental sector, where household incomes increased even after an adjustment for inflation. This could reflect increasing costs within this sector.**

- The **rental sector comprises two sub-sectors:**
  - **Formal sub-sector** which includes households renting a formal house or brick structure on a separate stand or yard, a flat in a block of flats, town/cluster/semi-detached house. This sub-sector comprised 1,5 million households in 2005, making up

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<sup>12</sup> Figures shown in italics are real household income figures, adjusted for inflation between 1999-2005 by a deflation factor of 1.2 i.e. assuming 30% cumulative inflation

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- 43% of the Rental Sector and 12% of the overall Housing Sector. This sub-sector has seen a decrease in size since 1999 (1,6 households in 1999 i.e. 100 000 households)).
- **Household sub-sector** which includes households renting a formal house, flat or room in a backyard or an informal dwelling or shack in a back yard. This sub-sector comprised 1,1 million households in 2005, making up 31% of the Rental Sector and 9% of the overall Housing Sector. This sub-sector has seen a slight increase in size since 1999 (1,0 to 1,1 households i.e. 100 000 households%).

Income levels of households have remained the same in both sub-sectors if inflation is taken into account.

**Current trends in South Africa** in respect of the rental sector are as follows<sup>13</sup>:

- South Africa's rental housing sector in general can support substantial growth.
- There has been an increased focus on the role of the Rental Sector in overall housing policy in the last five years, although as detailed above this has not resulted.
- While a key focus has been on Social Housing resulting in extensive subsidy, policy, institutional and facilitative support for this type of housing, more recently there is a **growing recognition of other rental housing types**.
- The development of the rental housing sector, particularly in inner cities is seen as a tool for urban stabilisation, regeneration and local economic development.
- There is a growing recognition of the role that the **informal rental sub-sector** plays.

### 3.1.2 Extent and contribution of Small Scale Landlords

**Small Scale Landlords are a positive contributor to the housing sector providing accommodation to an estimated 1,85 million households earning monthly incomes of R4 100 on average. Small scale landlords are generating significant rental income, which can be estimated to be approximately R421 million per month.**

There are **no statistics on the number and type of Small Scale Landlords** who provide and manage rental stock in South Africa. However applying data from the LHS of 2005 an estimation of the extent and contribution of Small Scale Landlords to the rental sector is set out in Table 3 below.

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<sup>13</sup> South African Rental Sector Overview, David Gardner, 2005

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Table 3: Estimation of size and contribution of Small Scale Landlords to the rental sector

Rental Sub-Sector	No of units	No managed by Small Scale Landlords		Estimated rental being paid	
		Assumption	No	Assumption	Amt per mn (R million)
Formal rental sub-sector	1,5	50%	0,75	R400 with 99% paying rent <sup>14</sup>	297
Household rental sub-sector	1,1	All	1,1	R150 with 75% paying rent <sup>15</sup>	124
Other	0,9	None	0	-	-
<b>Total</b>	<b>3,5</b>		<b>1,85</b>		<b>421</b>

### 3.1.3 Types and prevalence of Small Scale Landlords

**Inner City Landlords can be categorised into five types: Subletting Landlords which are the most prevalent, 1 Unit Landlords, 2+ Unit Landlords and Building Owners which are less and equally prevalent and Managing Agent Landlords which are the least prevalent.**

**Township Landlords are either Sub-letting or Unit Landlords and can be further subdivided into Formal Landlords, Informal Landlords and Tenant Landlords. The extent to which these types of Landlords occur within an area depends on historical, locational, planning and regulatory factors.**

The Literature Review<sup>16</sup> indicated that there are a **number of ways by which Landlords can be categorised including**<sup>17</sup>:

- **The size of operation** whereby the terms small scale landlords and large scale landlords are commonly used.
- **The landlords' residency status** including resident Landlords and non resident absentee Landlords.
- **Routes by which they became a Landlord** including purchased property, inherited or built themselves.

<sup>14</sup> Labour Force Survey 2005. Medium rental is applied

<sup>15</sup> Labour Force Survey 2005. Medium rental is applied

<sup>16</sup> See Resource Report 1

<sup>17</sup> Adapted from Landlordism in Third World Urban Low Income Settlement: A case for further research, Sunil Kumar, Urban Studies, May 96



- **Economic success**<sup>18</sup> including *subsistence landlords* who rent to sustain or augment the household's income, *petty bourgeois landlords* that use the income from renting to invest in improvements to their quality of life and *petty capitalist landlords* who own more than one property and produce dwellings for rent in order to expand and reproduce capital in the form of residential property.

For the purposes of this research the criteria applied in order to categorise Inner City and Township Landlords was determined to be as follows:

- The amount of units the Landlord owns
- The relationship the Landlord has with his/her tenants.
- The type of unit (formal or informal) and who built it

Application of these criteria to Inner City Landlords and Township Landlords resulted in the following categories of Landlords being determined:

- **Inner City:** Four categories of Landlords were identified as follows:
  - **Sub-letter Landlord:** A Sub-letter Landlord is defined as a Landlord who has legal title to a unit, a portion of which is rented out. Such a Landlord has a direct relationship with the tenants. The Landlord also stays in the same unit. The unit is formal.
  - **Unit Owner:** A Unit Owner is defined as a landlord who has legal title to a unit that s/he rents out and has a direct relationship with the tenants. The Landlord does not stay in the same unit. The unit is formal. There are two types of Unit Owners:
    - 1 Unit Owner: This comprises a Unit Owner that owns one unit only.
    - 2+ Unit Owner: This comprises a Unit Owner that owns two or more units (but less than a building or 200 units).
  - **Building Owner:** A Building Owner is defined as a landlord who has legal title to a building with residential units that he rents out to tenants. He has a direct relationship with tenants. The unit is formal. As the research focused on Small Scale Landlords only this category of Landlords is restricted to Building Owners that own less than 200 units.

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<sup>18</sup> Rental tenure in the cities of developing countries, Carole Rakodi, Urban Studies, May 1995

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- **Landlord that uses a Managing Agent:** This category of Landlords uses a Managing Agent and is subdivided into:
  - o Unit Landlord: As above but the Landlord does not have a direct relationship with his tenants. Rather the Landlord uses a Managing Agent to interface with the tenants. The Landlord does not stay in the same unit.
  - o Building landlord: As above but the Landlord does not have a direct relationship with tenants, but uses a Managing Agent to deal with the tenants
  
- **Township Landlords: All of the Landlords in Townships are Unit Owners,** with a very small number being Sub-letter Landlords. Townships Landlords are further categorised in respect of the type of unit and who built the unit. Three categories of Landlord are identified:
  - **Formal Unit Landlords:** Defined as Landlords who have a formal unit.
  - **Informal Unit Landlords:** Defined as Landlords who have an informal unit
  - **Tenant Unit Landlords:** Defined as Landlords where the tenant erected the unit and is renting a portion of the Landlords land

Figure 4 below shows the relationship between the categories of Inner City and Township Landlords.

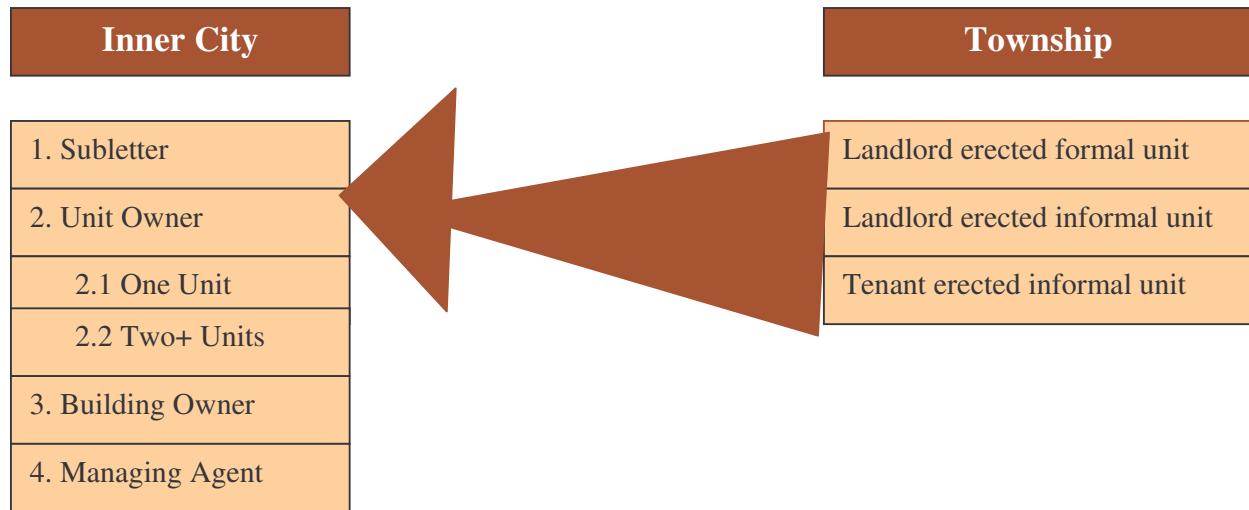


Figure 4: Types of Landlords

The above categorise of Landlords are applied where relevant in the analysis of Inner City and Township Landlords as detailed in the Sections that follow. In this regard the following is noted:

- **Building Owner Landlords:** Only 4 of this type of Landlords were identified as Building Landlords that owned more than 200 units were excluded from the study because they were not considered small scale (see the definition Section 2.2). The data for these 4 landlords is reported but the findings are indicative only, as they are not reflective of a statistical valid sample size.
- **Managing Agent Landlords:** As detailed in Section 2.1 above it was not possible to interview these Landlords directly as the Managing Agents refused to disclose contact details on the Landlords on the basis that it transgressed their ethical code. Other means to identify the Landlords were not successful. According interviews were held with the Managing Agents and therefore the data provides an understanding of such Landlords but is indicative only as it does not represent a valid statistical sample.

A total of 2062 units or stands with rental stock was visited in the two selected Inner City areas (Tshwane and Hillbrow/Berea) that were the focus of this research. Table 4 below shows the prevalence of the Landlord categories identified above in these Inner Cities areas shown by geographic area.

Table 4: Prevalence of Inner City Landlord categories

Type	Definition	% of sample		
		Tshwane	Hillbrow/ Berea	Total
Sub-letting Landlord	Has legal title (ownership or lease) Portion rented out. Stays in unit Direct relationship with tenant	34	40	38
1 Unit Landlord	Has legal title to one rental unit Does not stay in unit Direct relationship with tenant	20	26	23
2+ Unit Landlord	Has legal title to more than one rental unit (up to 200) Does not stay in unit Direct relationship with tenant	17	16	17
Building Landlord	Legal title to a building with rental units Direct relationship with tenant	2	1	2
Managing Agent Landlord	As for Unit or Building Landlord above but does not have direct relationship with Tenants but uses a Managing Agent	27	17	21
Total		100	100	100

On the basis of the above table it is evident that:

- **Most Landlords are Sub-Letting (38%).**
- There are a **similar number of 1 Unit (23%), 2+ Unit (17%) and Managing Agent Landlords (21%).**
- There are **very few Building Landlords (2%).**
- The dispersion of the categories of Landlords between the two geographic areas in which the surveying was undertaken (Tshwane and Hillbrow/Berea) is similar.

Table 5 below shows the prevalence of the Landlord categories identified in Townships by geographic area.

Table 5: Prevalence of Township Landlords

Type	Definition	% of sample*		
		Katorus	Orlando East	Cato Manor
Formal Landlord	Landlord erected formal unit	41	32	13
Informal Landlord	Landlord erected informal unit	33	10	76
Tenant Landlord	Tenant erects unit/rents land	18	43	2

\* Due to the manner in which the Township Landlords were surveyed, each area must be analysed as a distinct sample and a total cannot be reflected

On the basis of the above table it is evident that the different categories of Landlords occur differently across the three areas. In Katorus there are more Formal Landlords, in Orlando East more Tenant Landlords and in Cato Manor more Informal Landlords. This reflects the **situational differences** that occur in each area as a result of historical, locational, planning and regulatory factors.

### 3.1.4 Profile of Small Scale Landlords

**Inner City and Township Landlords are different. Township Landlords are on average one of the most marginalized sectors of society, poor, aged women with minimal sources of regular income. Inner City Landlords are predominantly male, well educated, and while incomes are low for some, most are formally employed. Managing Agent Landlords are distinct from the other Inner City Landlords in that they are predominantly white or corporate entities. With the exception of Building Owners and Managing Agent Landlords, all other Landlord categories operate their business informally and have limited business experience. Not all Landlords are entrepreneurial. The data suggests a ladder of growth could be occurring.**

On the basis of the survey undertaken of Inner City Landlords and research into Township Landlords, Table 6 below provides an overview of the profile of the different Landlord categories in Inner Cities and Townships in terms of demographic characteristics, the extent to which they operate as a business and the extent to which they show entrepreneurial characteristics (i.e. prepared to take risk and invest). (See Resource Reports 5 and 6 for details)

Table 6: Profile of Landlord categories

Area	Category	Demographic	Operate as a business	Extent of entrepreneurship
Inner City	Sub-letter	<ul style="list-style-type: none"> <li>- Half are <b>male</b> (53%)</li> <li>- Average age <b>32</b></li> <li>- Majority <b>African</b></li> <li>- <b>Well educated</b> (70% matric or above)</li> <li>- <b>Low incomes</b> (76% below R3000)</li> <li>- Under half (42% ) <b>formally employed</b></li> </ul>	<p><b>Mean no of years as landlord: 4</b>  <b>Manage the property themselves</b> (100%)  <b>Operate informally</b> : 96% not registered, 96% do not keep financial record  <b>Limited profitability</b> : 32% made money</p>	<p><b>Some show characteristics of entrepreneurship :</b></p> <ul style="list-style-type: none"> <li>- 7% purchased the unit</li> <li>- 45% motivated by the investment</li> <li>- 49% motivated by monthly income</li> <li>- 69% would like to acquire additional stock</li> </ul>
	1 Unit Landlord	<ul style="list-style-type: none"> <li>- Many are <b>male</b> (60%)</li> <li>- Average age <b>36</b></li> <li>- Majority <b>African</b></li> <li>- <b>Well educated</b> (75% matric or above)</li> <li>- <b>Low incomes</b> (65% below R3000)</li> <li>- Over half (58% ) <b>formally employed</b></li> <li>- Most (73%)<b>live in neighbourhood</b></li> </ul>	<p><b>Mean no of years a landlord: 4</b>  <b>Manage the property themselves</b> (67%)  <b>Operate informally</b> : 86% not registered, 96% do not keep financial record  <b>Limited profitability</b> : 32% made money</p>	<p><b>Generally show characteristics of entrepreneurship :</b></p> <ul style="list-style-type: none"> <li>- 38% purchased the unit</li> <li>- 40% motivated by the investment</li> <li>- 56% motivated by monthly income</li> <li>- 56% would like to acquire additional stock</li> </ul>
	2+ Unit Landlord	<ul style="list-style-type: none"> <li>- Many are <b>male</b> (64%)</li> <li>- Average age <b>41</b></li> <li>- Majority <b>African</b></li> <li>- <b>Well educated</b> (62% matric or above)</li> <li>- <b>Low incomes</b> (54% below R3000)</li> <li>- Over half (54% ) <b>formally employed</b></li> <li>- Most (67%)<b>live in neighbourhood</b></li> </ul>	<p><b>Mean no of years a landlord: 5</b>  <b>Manage the property themselves</b> (62%)  <b>Operate informally</b> : 90% not registered, 97% do not keep financial record  <b>Profitable</b> : 61% made money</p>	<p><b>Show characteristics of entrepreneurship:</b></p> <ul style="list-style-type: none"> <li>- 44% purchased the unit</li> <li>- 45% motivated by the investment</li> <li>- 50% motivated by monthly income</li> <li>- 64% would like to acquire additional stock</li> </ul>
	<i>Building Owner<sup>19</sup></i>	<ul style="list-style-type: none"> <li>- <i>Many are male</i> (75%)</li> <li>- <i>Average age 58</i></li> <li>- <i>Well educated</i> (100% matric or above)</li> <li>- <i>Higher incomes</i> (25% below R3000)</li> <li>- <i>One quarter</i> (25% ) <i>formally employed</i></li> <li>- <i>One quarter</i> (25%)<i>live in neighbourhood</i></li> </ul>	<p><i>Mean no of years a landlord: 8,5</i>  <i>None manage the property themselves – use a caretaker</i>  <b>Operate formally</b> : 96% registered, 96% keep financial record  <b>Profitable</b> : 75% made money</p>	<p><i>Show characteristics of entrepreneurship:</i></p> <ul style="list-style-type: none"> <li>- <i>100% purchased the unit</i></li> <li>- <i>100% motivated by the investment</i></li> <li>- <i>75% would like to acquire additional stock</i></li> </ul>
	<i>Managing Agent<sup>20</sup></i>	<ul style="list-style-type: none"> <li>- <i>Either corporate entity or male</i> (67%)</li> <li>- <i>Average age 36-55</i></li> <li>- <i>Majority white</i></li> </ul>	<p><i>None manage the property themselves</i>  <b>Operate formally</b> : 96% registered, 96% keep financial record</p>	

<sup>19</sup> Sample not statistically valid, figures indicative only

<sup>20</sup> Sample indicative only

Area	Category	Demographic	Operate as a business	Extent of entrepreneurship
Township Landlords	Formal Landlord	<ul style="list-style-type: none"> <li>- Most are <b>female</b> (66-75%)</li> <li>- Av age <b>53/54 but 39 in Cato Manor</b></li> <li>- Majority <b>African</b></li> <li>- <b>Poor education except in Cato Manor</b></li> <li>- <b>Low incomes</b></li> <li>- <b>Unemployment high/many are retired. Cato Manor 45% employed</b></li> <li>- <b>All live in neighbourhood</b></li> <li>- <b>Income earned either sole income or supplements another income stream</b></li> </ul>	<p><b>All manage the property themselves</b>  <b>Operate informally</b>  <b>Business experience limited</b> (less so in Cato Manor)</p>	<p><b>Some show characteristics of entrepreneurship:</b></p> <ul style="list-style-type: none"> <li>- Predominantly motivated by earning income 51-94%</li> <li>- Less than 11% added new unit in last 5 years except in Cato Manor where 57% did</li> <li>- 76%+ want to keep current status quo, except Cato Manor where 46% do</li> <li>- Less than 16% want to improve or expand, except in Cato Manor where 51% do.</li> </ul>
	Informal Landlord	<ul style="list-style-type: none"> <li>- Most are <b>female</b> (68-72%)</li> <li>- Av age <b>46/42 but 39 in Cato Manor</b></li> <li>- Majority <b>African</b></li> <li>- <b>Poor education</b></li> <li>- <b>Low incomes</b></li> <li>- <b>Unemployment high/many are retired. Cato Manor 45% employed</b></li> <li>- <b>All live in neighbourhood</b></li> <li>- <b>Income earned either sole income or supplements another income stream</b></li> </ul>	<p><b>All manage the property themselves</b>  <b>Operate informally</b>  <b>Business experience limited</b> (less so in Cato Manor)</p>	<p><b>Some show characteristics of entrepreneurship:</b></p> <ul style="list-style-type: none"> <li>- Predominantly motivated by earning income 53-86%</li> <li>- Less than 17% added new unit in last 5 years except in Cato Manor where 76% did</li> <li>- 57%+ want to keep current status quo, except Cato Manor where 26% do</li> <li>- 29-38% want to improve or expand, except in Cato Manor where 69% do.</li> </ul>
	Tenant Landlord	<ul style="list-style-type: none"> <li>- Most are <b>female</b> (50-71%)</li> <li>- Av age <b>47/53 but 41 in Cato Manor</b></li> <li>- Majority <b>African</b></li> <li>- <b>Poor education</b></li> <li>- <b>Low incomes</b></li> <li>- <b>Unemployment high/many are retired. Cato Manor 45% employed</b></li> <li>- <b>All live in neighbourhood</b></li> <li>- <b>Income earned either sole income or supplements another income stream</b></li> </ul>	<p><b>All manage the property themselves</b>  <b>Operate informally</b>  <b>Business experience limited</b> (less so in Cato Manor)</p>	<p><b>Some show characteristics of entrepreneurship:</b></p> <ul style="list-style-type: none"> <li>- Predominantly motivated by earning income 50-83%</li> <li>- Less than 24% added new unit in last 5 years except in Cato Manor where 50% did</li> <li>- 52%+ want to keep current status quo, except Cato Manor where 33% do</li> <li>- 35/36% want to improve or expand, except in Cato Manor where 50% do.</li> </ul>

On the basis of the above table the following is evident:

- **Inner City Landlords and Township Landlords are different.** They have a different demographic profiles and operate in different markets:
    - **Township Landlords** are on average one of the **most marginalized sectors of society**, poor, aged women with minimal sources of regular income. In most cases the income from rental stock offers a critical augmentation to generally low incomes.
    - **Inner City Landlords** are **predominantly male, well educated and while incomes are low for some, most are formally employed.** Approximately half became a Landlord as they need the income, however for approximately one quarter they became a Landlords because of the investment potential.
  
  - **Managing Agent Landlords are distinct from the other Inner City Landlords** in that they are predominantly white or corporate entities. This could explain the reason why they use an intermediary like a Managing Agent in that they are culturally and socially different from their Tenants.
  
  - Landlords with a smaller number of units to manage (**Subletting, Township Landlords, Unit Landlords**) **manage their rental stock personally**, while Landlords with a greater number of units under management (Building Owner and Managing Agent Landlords) use **intermediaries**.
  
  - There are **strong similarities** in terms of demographic characteristics and the way in which the business is operated in Inner Cities between:
    - Subletting, 1 Unit and 2+ Unit Landlords
    - Building Owners and Managing Agent Landlordsand in Townships between :
    - Formal, Informal and Tenant landlords
  
  - With the exception of Building Owners and Managing Agent Landlords all other Landlords categories **operate their businesses informally** and have **limited business experience**.
-



- **Not all Landlords are entrepreneurial** and only some of them are investing and taking risk and wanting to expand their rental portfolios. This is evident in respect of both Inner City and Township Landlords. With respect of Township Landlords two distinct categories were identified:
  - **Subsistence Landlords** – who are generally pensioners using the rental income to augment pensions. These Landlords do not want to expand.
  - **Entrepreneurial Landlords** – who are generally younger people pursuing landlordism as a means of earning primary income or augmenting existing income and are interested in improving their existing and/or developing new stock.

This finding supports the international research (see Resource Report 1) where it is indicated that the motivation for Landlords to invest in rental stock varies with the type of Landlord. Landlords who have access to capital and view the residential rental property as an investment option will be concerned with rate of return on the investment. Landlords whose access to capital is limited by savings and whose investment is intermittent, are likely to consider other factors such as supplementing income.

- **The data suggests that a ladder of growth could be occurring with respect to Small Scale Landlords in Inner Cities** in that :
  - Subletting landlords are younger and have less income
  - Landlords with 1 unit are slightly older and have more income
  - Landlords with 2+ units are even older, have more income and more are making profits
  - Landlords with buildings are even older and have the greatest income and most are making profits.

This does suggest that as the more entrepreneurial Landlords become successful in a particular category and acquire more income and experience, they move to the next category thus moving from subletting, to 1 unit, to 2+ units, to a Building.

This finding is substantiated in respect of the interviews undertaken with Successful Landlords (see Resource Report 7) where there were examples provided of Landlords starting with one unit and then slowly as they gain experience and more income over time purchasing additional units.

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However this must be interpreted with care as the international review (see Resource Report 3) clearly indicates that Entrepreneurs do not move easily from one rung of the ladder to the next. They often move backwards and forwards, or may skip a rung or experience failure.

### 3.1.5 Stock and operating procedures of Small Scale Landlords

**The type of stock provided by Small Scale Landlords varies in terms of the category of Landlord but includes a room, a flat or a formal or informal unit. Access to services is generally good in Inner Cities but is relatively poor in Townships. While the quality of the stock provided was not surveyed, anecdotal evidence indicates that a large number of Township Landlords (providing both formal and informal units) and some Inner City Landlords provide stock that is of poor quality. Research shows that such stock often has a serious impact on the occupant's health and well being and interventions are required to improve the quality of this stock.**

**Generally Subletting Landlords, Township Landlords, 1 Unit and 2+ Unit Landlords manage the stock themselves on an informal basis. Building Landlords and Managing Agent Landlords use agents to manage the stock on a formal basis. Subletting, Township, 1 Unit and 2+ Unit Landlords have less problems collecting rentals which could be the result of the more personal relationship they have with Tenants.**

On the basis of the survey undertaken of Inner City Landlords and research into Township Landlords, Table 7 below provides an overview of the type of stock provided by and operating procedures of the different Landlord categories in Inner Cities and Townships.<sup>21</sup>

#### 3.1.5.1 Type of stock

As shown in Table 7 below the type of stock being offered by Small Scale Landlords is as follows:

- In the **Inner City**:
  - **Sub-Letters** are providing a room. The majority of this category of Landlords (82%) lease the property themselves and do not own it.

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<sup>21</sup> See Resource Reports 5 and 6 for details

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- **All other categories of Landlords** (1 Unit, 2+ Unit, Building) provide a flat. The majority of these Landlords (1 Unit (62%), 2+ Unit (74%) and Building (100%)) own the property.
- In **Townships**, **Formal Landlords** provide a formal unit or a room in a house, **Informal Landlords** provide informal units and **Tenant Landlords** a combination of both. The majority (91-100%) of Township Landlords own their property.

Access to services is **generally good in Inner Cities**. Many units (69%) have bathing facilities in the unit, toilet facilities in the unit (68%) and electricity (100%). Access to services in **Townships is relatively poor**. Most units use electricity that is taken from the main house. Very few Landlords provide access to a hot water tap on the site (less than 13%). Most stands have 1 flush toilet on the stand, to which tenants have access, although most share with the main house or other Informal Rental dwellers. Ceramic or fixed basins and baths are not very commonly found on the stand (less than 15%).

Neither the Inner City Survey nor the Township surveys assessed the quality of the accommodation provided by Small Scale Landlords. Anecdotal evidence indicates that a **large number of Township Landlords who provide both formal and informal units and some of the Inner City Landlords** are providing stock that is of a very poor quality. Research (see Resource Report 1) shows that such stock often has a **serious impact on the occupants' health and well being. Interventions are required to improve the quality of rental stock provided by Small Scale Landlords particularly in Townships** (particularly in respect of informal stock). In this regard as indicated in the Literature Review (see Resource Report 1) the focus should be on reducing indoor air pollution, overcrowding and dampness and improving access to services.

In South Africa the design and construction of housing stock (whether for ownership or rental) must comply with the relevant requirements of the National Building Regulations; Requirements laid by the National Home Builders Registration Council (NHBRC) and Local Government Town Planning and Building Ordinances and Bylaws. The National Building Regulations provide a wide range of specifications, the NHBRC requirements and Local Government Town Planning and Building Ordinances and Bylaws require relatively high specifications.

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While these specifications vary between Local Governments they are generally significantly higher than what is affordable by Small Scale Landlords, particularly those providing backyard rental accommodation. This results in much of this stock not complying.

There is therefore a need for such requirements to be reviewed so as to make them more applicable to the sector. In this regard regulatory requirements should be simple, accessible and understood by all concerned. In addition the **challenge is to understand how such dwellings can be effectively upgraded to ensure the health of the occupants, given the resource constraints** of both Small Scale Landlords and their tenants.

Table 7: Stock and operating procedures of Small Scale Landlords

Characteristic	Measure	Inner City						Township		
		Sub-Letter	1 Unit	2+ Unit	Building	Agent-Unit	Agent-Bld	Formal	Informal	Tenant
Stock	Type	Room (98%)	Flat (95%)	Flat (80%)	Flat (100%)	Sectional Title (100%)	Owns bldg	Formal unit/ room in house	Informal unit	Formal/ Informal unit
	% who own property	9	62	74	100	-	-	96-99 <sup>22</sup>	91-100	91-99
	% who lease property	82	36	26	-	100	100	-	-	-
	% with electricity	100	100	100	100	-	-	-	-	-
	% with toilet in unit	74	76	72	100	-	-	-	-	-
	% with stove provided	65	58	67	100	-	-	-	-	-
	% with access to hot water tap	-	-	-	-	-	-	2-6	1-2	0-13
	% with access to a flush toilet	-	-	-	-	-	-	82-96	95-100	89-97
	% with access to a basin	-	-	-	-	-	-	0-6	0-2	6-15
	% who made changes to unit when acquired	15	23	8	76	-	-	-	-	-
Type of changes	Tiles/carpets/paint/bilt extra room					-	-	-	-	-
Operating procedures	Rental charged pm (R)	898	1038	1053	1183	1701	1755	97-143	99-109	199-225
	% who take a deposit	29	40	51	100	100	100	18-30	0-14	11-18
	% who provide written invoice	24	46	23	75	100	100	-	-	-
	% paid in cash	78	56	72	0	33	0	94-99	91-100	92-100
	% paid in bank account	21	38	26	100	67	100	-	-	-
	% who experience non payment of rental	23	27	28	100	40	30	Defaults are low – although rescheduling of rentals is common		

<sup>22</sup> Highest and lowest between the 3 areas reflected

Characteristic	Measure	Inner City						Township		
		Sub-Letter	1 Unit	2+ Unit	Building	Agent-Unit	Agent-Bld	Formal	Informal	Tenant
	Methods of addressing non payment	Talk to tenant, Eviction, Written warning				-	-	-	-	-
	% who have a written contract	15	18	21	100	100	100	Generally no written agreements		
	% who have evicted a tenant	20	18	28	100	13	55	9-21	0-20	11-23
	% who include services in rent	64	60	77	-	-	-	88-100	88-100	83-99
	% who charge services separately	29	36	8	75	-	-	-	-	-
	% who have undertaken maintenance	19	40	51	75	-	-	< 15%		
	% who believed it easy to find tenants	66	62	72	100	-	-	70-81% overall		

### 3.1.5.2 Operating procedures

All categorise of Landlords in the Inner City **rent out their stock on a monthly basis** (over 98%). The Nurcha survey did not determine the extent to which rental is paid monthly in Townships.

The amount of rental charged does **appear to be related to location and quality of stock, as well as the degree of formality of the business**, with Township Landlords charging the lowest rentals. Rentals then increase progressively from Subletting, 1 Unit and 2+ Unit, Building Landlord and Managing Agent Landlords who realise the highest rentals as follows:

- Township Landlords realise between R97 and R225
- Subletters realise R898
- 1 Unit and 2+Unit Landlords realise R1038 and R1053 respectively
- Management Agent and Building Landlords realise the highest rentals per month (R1728 and R1183 respectively)

In Townships the survey indicated potential elasticity in rental levels. The market is price sensitive and rentals conform to ‘informal ceilings’ in many areas. Products delivered in this market may find it difficult to bend these informal threshold levels, therefore affecting financial viability.

Generally Subletting Landlords, Township Landlords, 1 Unit and 2+ Landlords operate on an **informal basis**, while most Building Owners and Managing Agent Landlords operate on a **formal basis**. In this regard many Subletting, Township, 1 Unit and 2+ Unit landlords do not take a deposit, have written contracts or provide written invoices or receipts. Generally Building Owners and Managing Agent Landlords do.

Subletting, Township and 1 Unit and 2+ Unit Landlords **manage the business themselves** and generally collect rentals in cash. In the case of Building and Managing Agent Landlords the **rental is paid into a bank account**. In respect of Township Landlords, rentals are mostly paid in cash, but can also take the form of, for instance, the purchasing of electricity or payments in kind such as undertaking regular chores or preparing meals. Subletting, Township Landlords, 1 Unit and 2+ Unit Landlords generally include services in the rent. Building and Management Agent Landlords generally charge for services separately.

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Subletting (27%) and Unit Landlords (1 and 2+) (23-28%) have **less problems collecting rent** than Building Landlords (100%) and Landlords using Managing Agents (30-40%). This could be the result of the **more personal relationship** which the former have with their Tenants. In Townships, levels of default are low although rescheduling of rentals is relatively common.

The use of eviction by Landlords **appears to be limited** in respect of both Township and Inner City Landlords. Of those who do use eviction most indicated that they do not experience problems in this regard.

Demand for stock appears high and most Landlords in both Inner Cities and Townships indicated that it is easy to find tenants (over 62%). Township Landlords report that the number of tenants coming and asking for a place to rent is at a rate of 6-12 people per month and that vacancy is effectively zero. The methods used in Inner Cities include being asked by the tenant, advertising, referral from family and friends and referable from the previous tenant.

When selecting Tenants, as with other private rental markets, factors influencing the ability of the Tenant to pay the rental are taken into account by most Landlords in both Inner Cities and Townships. In Inner Cities the most desirable Tenants are formally employed males. In Townships factors taken into consideration include income levels, stability of income, previous references and kinship arrangements (language, culture etc).

The extent to which maintenance is undertaken appears to be related to the amount of rental that is realised. Township and Subletting Landlords undertake the least maintenance (<15% and 19% respectively), followed by 1 Unit and 2+ Unit Landlords (40% and 51% respectively), followed by Building Landlords (75%). In respect of Inner city Landlords the type of maintenance undertaken is generally regular painting, fixing plumbing and damage and addressing structural problems.

In Inner Cities the two greatest threats to the viability of Landlords are ineffective Body Corporates and building hijackings.

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### 3.1.6 Landlord Tenant Relationship

**There are strong similarities between Tenants living in Inner Cities and Townships being male, young and formally employed. In Inner cities many tenants view their rental accommodation as temporary. In Townships at least a quarter believe they will live in backyard rental forever. Approximately half of the Inner City Tenants are stable and half are transitional. Township Tenants have been living for rental accommodation for longer.**

**Generally both Landlords and Tenants believe that they have a good relationship. Most Tenants are satisfied with the quality of the unit and the services they receive.**

**For most categories of Landlords legal arrangements with their Tenants are informal. Despite this there are high levels of understanding of roles and responsibilities.**

#### 3.1.6.1 Tenant Profile

On the basis of the surveys undertaken into Landlords in Inner Cities and Townships (see Resource Reports 5 and 6), Table 8 below provides an overview of the profile of Tenants living in rental accommodation in Inner Cities and Townships. In respect of Inner Cities two categories of tenants were identified namely those renting a part of a unit (room) and those renting the entire unit. In Townships, the profile is provided in terms of the Tenants living in the housing stock provided by the different categories of Township Landlords (Informal Unit, Formal Unit and Tenant Erected)

On the basis of Table 8 it is evident that there are strong similarities between Tenants living in Inner cities and Townships being male, young and formally employed. However Inner City tenants are better educated and earn higher incomes. Inner City Tenants have a similar profile to Subletting, 1 Unit and 2+ Unit Landlords. In Townships, the Tenants are generally better of than the Landlords, having better education levels and being formally employed. Township Tenants have very small households with a third being single person households and another third 2 person households.

Table 8: Tenant Profile

Area	Category	Demographic	Length as tenant and attitudes to accom	Rental arrangements
Inner City	Tenants renting part of a unit	<ul style="list-style-type: none"> <li>- More than half are <b>male</b> (55%)</li> <li>- Average age <b>31</b></li> <li>- <b>Well educated</b> (64% matric or above)</li> <li>- <b>Incomes medium to low</b> (37% earn above R2500)</li> <li>- Over one third (36%) <b>formally employed</b></li> </ul>	<p><b>Mean no of years as Tenant:</b> 42% - 1 year or less, 47% - 2 to 5 years</p> <p><b>Most view rental unit as a temporary place</b> close to work (70%)</p> <p><b>Many have another home</b> (68%)</p>	<ul style="list-style-type: none"> <li>- Half feel it would be <b>difficult to be evicted</b> (49%)</li> <li>- All <b>pay rental monthly</b></li> <li>- Half <b>pay rent to Landlord/Caretaker</b> (53%) and under half into <b>Bank Account</b> (44)</li> <li>- Most have <b>services included in rent</b> (89%)</li> <li>- Half paid a <b>deposit</b> (55%)</li> <li>- Under one quarter <b>negotiate with Landlord if they cannot pay rent</b> (21%)</li> <li>- Most <b>deal with a Caretaker</b> (72%)</li> <li>- Half got the unit by being <b>referred from a friend/family</b> (40%)</li> </ul>
	Tenant renting the entire unit	<ul style="list-style-type: none"> <li>- Half are <b>male</b> (50%)</li> <li>- Average age <b>30</b></li> <li>- <b>Well educated</b> (78% matric or above)</li> <li>- <b>Incomes medium to low</b> (43% earn above R2500)</li> <li>- Under half (43%) <b>formally employed</b></li> </ul>	<p><b>Mean no of years as Tenant:</b> 58% - 1 year or less, 32% - 2 to 5 years</p> <p><b>Half view rental unit as a temporary place</b> close to work (46%)</p> <p><b>Most have another home</b> (81%)</p>	<ul style="list-style-type: none"> <li>- Most feel it would be <b>difficult to be evicted</b> (85%)</li> <li>- All <b>pay rental monthly</b></li> <li>- One third <b>pay rent to Landlord/Caretaker</b> (32%) and over half into <b>Bank Account</b> (57)</li> <li>- One third have <b>services included in rent</b> (29%)</li> <li>- Most paid a <b>deposit</b> (76%)</li> <li>- Half <b>negotiate with Landlord if they cannot pay rent</b> (52%)</li> <li>- Most <b>deal with a Caretaker</b> (64%)</li> <li>- Half got the unit by being <b>referred from a friend/family</b> (40%), one third saw an advert (32%)</li> </ul>

Area	Category	Demographic	Length as tenant and attitudes to accom	Rental arrangements
Townships	Informal Unit	<ul style="list-style-type: none"> <li>- Over half are <b>male</b> (50-57%)</li> <li>- Average age <b>30 - 36</b></li> <li>- <b>Low levels of education</b> (22-30% matric or above)</li> <li>- <b>Incomes low</b> (75% earn below R1500)</li> <li>- A third to a half <b>employed full time</b></li> </ul>	<p><b>Mean no of years as Tenant:</b> 6-8 years</p> <p>Most dominant reason for renting is they <b>have no other option</b> (12-25%)</p> <p><b>Most do not have another home</b> (81-100%)</p> <p>Approximately one quarter consider their <b>current accommodation to be short term</b> (16-27%).</p> <p>A quarter plan to <b>live in a backyard dwelling forever</b> (24%)</p> <p>Most believe it will be <b>difficult to find another unit</b> (81-86%)</p>	<ul style="list-style-type: none"> <li>- One third <b>pay rent to</b></li> <li>- Under a quarter paid a <b>deposit</b> (20-21%)</li> <li>- Unit was found predominantly by walking the area (62-64%) or by being <b>referred from a friend/family</b> (32-36%)</li> </ul>
	Formal Unit Tenant	<ul style="list-style-type: none"> <li>- Over half are <b>male</b> (46-58%)</li> <li>- Average age <b>29-34</b></li> <li>- <b>Levels of education moderate</b> (30-60% matric or above)</li> <li>- <b>Incomes low</b> (75% earn below R1500)</li> <li>- A third to a half <b>employed full time</b></li> </ul>	<p><b>Mean no of years as Tenant:</b> 6-8 years</p> <p>Most dominant reason for renting is they <b>have no other option</b> (3-20%)</p> <p><b>Most do not have another home</b> (81-100%)</p> <p>Approximately one quarter consider their <b>current accommodation to be short term</b> (16-27%).</p> <p>A quarter plan to <b>live in a backyard dwelling forever</b> (24%)</p> <p>Most believe it will be <b>difficult to find another unit</b> (60-89%)</p>	<ul style="list-style-type: none"> <li>- Under a quarter paid a <b>deposit</b> (6-12%)</li> <li>- Unit was found predominantly by walking the area (41-59%) or by being <b>referred from a friend/family</b> (41-59%)</li> </ul>
	Tenant Erected	<ul style="list-style-type: none"> <li>- Over half are <b>male</b> (33-60%)</li> <li>- Average age <b>36-39</b></li> <li>- <b>Low levels of education</b> (18-33% matric or above)</li> <li>- <b>Incomes low</b> (75% earn below R1500)</li> <li>- A third to a half <b>employed full time</b></li> </ul>	<p><b>Mean no of years as Tenant:</b> 6-8 years</p> <p>Most dominant reason for renting is they <b>have no other option</b> (5-33%)</p> <p><b>Most do not have another home</b> (81-100%)</p> <p>Approximately one quarter consider their <b>current accommodation to be short term</b> (16-27%).</p> <p>A quarter plan to <b>live in a backyard dwelling forever</b> (24%)</p> <p>Most believe it will be <b>difficult to find another unit</b> (64-85%)</p>	<ul style="list-style-type: none"> <li>- Under a quarter paid a <b>deposit</b> (0-14%)</li> <li>- Unit was found predominantly by walking the area (64-73%) or by being <b>referred from a friend/family</b> (25-33%)</li> </ul>

**In Inner Cities many tenants view their rental accommodation as temporary.** Most Tenants rent the unit because it is close to work and many have another home. In Townships most Tenants rent because they had no other option and many do not have a house elsewhere. A quarter considers their current accommodation to be short term, but another quarter plan to live in a backyard unit forever.

**Approximately half of the inner city tenants are stable and half are transitional. Township Tenants** have been living in rental accommodation for longer (between 4 to 6 years) than their Inner City counterparts (1 to 2 years). Most believe it will be very difficult to find other accommodation if they left their current accommodation, this is consistent with the low levels of vacancies being experienced by Landlords and the ease with which they are able to find new tenants (see Section 3.1.5.2).

**As detailed in Table 8 above the Tenants interviewed indicated the following with respect to their rental arrangements<sup>23</sup>. There is generally a high level of compliance between these responses and those received from the Landlords interviewed (see Section 3.1.5.2).**

- In Inner Cities all Tenants pay rental monthly. More than half paid a deposit. One-third to a half pay rent to the Landlord/Caretaker and approximately half into a bank account. In Townships under a quarter paid a deposit.
- In Inner Cities, Tenants renting part of a unit generally have their services included in their rental, Tenants renting the entire unit generally pay rental separately.
- In Inner Cities, most Tenants deal with the Caretaker and most will negotiate if they cannot pay their rent.
- In Inner Cities more than half of Tenants feel it would be difficult to be evicted.

### **3.1.6.2 Landlord Tenant Relationship**

On the basis of the surveys undertaken into Landlords in Inner Cities and Townships (see Resource Reports 5 and 6), Table 9 below sets out key views and issues pertaining to the relationship between Landlords and Tenants as reflected from the perspective of the Landlords and Tenants interviewed respectively.

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<sup>23</sup> This section covers Inner City Tenants mainly - questions were not covered in the survey of Tenants in Townships

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As detailed in Table 9 it is evident that **Landlords in Inner Cities believe that the relationship with their tenants is good. This is supported by the Tenants themselves (although to a lesser extent). In Townships most Tenants feel that they have a good relationship with their Landlord.** Many Tenants in Townships, despite the poor quality of the stock within which they live (see Section 3.1.5.1), **express moderate to high levels of satisfaction both with the quality of the unit within which they live and the services they receive.**

For Township, Subletting and Unit Landlords **legal arrangements with their Tenants is largely informal. Many do not have an agreement with their tenants and very few have a written contract.** House rules are rarely in writing although some have a verbal understanding. This is in contrast to the Building and Managing Agent Landlords where 100% have a written contract usually with House rules contained in the contract. There is generally very limited use of Tenant Committees.

Despite the limited use of written contracts, there appears to be high levels of understanding of roles and responsibilities by both Landlords and Tenants, both within Inner Cities and Townships.

While there appears to be no specific correlation between having written contracts and good tenant relations, the use of a written contract is good practice. Some of the Successful Landlords (particularly in Township areas) indicated that they were beginning to change to written contracts for this reason (see Resource Report 7). **Accordingly it does appear that written contract would be beneficial and Landlords should be encouraged to use such contracts.**

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Table 9: Landlord Tenant Relationship

Measure	Inner City						Township						
	Landlords					Tenants		Landlords			Tenants		
	Sub-letter	1 Unit	2+ Unit	Build-ign Owner	Agent	Rent part of unit	Rent entire unit	Inform-al Unit	Form-al Unit	Tenant	Inform-al Unit	Formal Uni-t	Tenant
% Feel relationship is good	89	87	87	100	-	67	72	-	-	-	83-91	83-93	83-93
Landlord key roles	Fix plumbing, fittings, electricity, painting					Structural, fix services and damages		-	-	-	Repairs unit		
Tenant key roles	Change light bulbs					Change light bulbs		-	-	-	-	-	-
% Who fell landlord treated them fairly	-	-	-	-	-	79	69	-	-	-	-	-	-
% Who have written agreement	15	18	21	100	100	15	51	0-2			-	-	-
% Who have written house rules	5	13	8	50	100	8	19	-	-	-	46-74	34-74	17-75
% Who feel that they Landlord is meeting their needs	-	-	-	-	-	64	36	-	-	-	-	-	-
% Satisfied with quality of unit	-	-	-	-	-	-	-	-	-	-	58-64	75-84	58-84
% Satisfied with quality of services	-	-	-	-	-	-	-	-	-	-	74-91	80-89	75-100
% Who have tenant committee	12	7	0	0	-	7	18	-	-	-	-	-	-

### 3.1.7 Finance and support

**Access to financial products for Small Scale Landlords is poor. Those Landlords operating their businesses on an informal basis have less access to financial products than those operating on a more formal basis. Most Township Landlords, who built units, used their own savings to finance it. In addition, there is reluctance amongst Township Landlords to use the house as collateral.**

**The lack of loan finance for Small Scale Landlords is due to the fact that commercial Banks remain extremely risk averse and other Development finance institutions focus either on Social Housing Institutions or provide finance in a manner that is inappropriate or is difficult to access for Small Scale Landlords. The most effective source of funding is that provided by TUHF, which has a specific focus on Small Scale Landlords. International experience indicates that making finance available to Small Scale Landlords should occur on a ‘credit-plus’ basis where finance is coupled with business support services, which are provided on an ongoing basis.**

#### 3.1.7.1 Access and use of financial products

On the basis of the surveys of Inner City and Township Landlords (See Resource Reports 5 and 6), Table 10 below provides an overview of access and use of financial products by Small Scale Landlords.

On the basis of the Table it is evident that **access to financial products by Small Scale Landlords is poor**. In addition that **those Landlords operating their businesses on an informal basis have less access** than those operating on a more formal basis. Just under one third of Sub-Letting and Unit Landlords accessed a loan from a financial institution to purchase their unit, with most using their own money. Less than one quarter of these Landlords have savings accounts with less than one fifth having current or cheque accounts. Approximately three quarters (75%) of Building Landlords accessed a loan. Approximately half have a current or cheque account. The Survey of Successful Landlords (see Resource Report 7) indicates that the most common method of acquiring property for these Landlords (other than those operating in Townships) was to purchase the property using a bond from a commercial bank.

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Table 10: Financial circumstances of Small Scale Landlords

Characteristic	Measure	Inner City						Township		
		Sub-Letter	1 Unit	2+ Unit	Building	Agent-Unit	Agent-Bld	Formal	Informal	Tenant
Personal Banking	% Savings Account	23	25	21	25	-	-	-	-	-
	% Current or cheque account	3	13	18	50	-	-	-	-	-
	% Mortgage bond	0	2	0	25	-	-	-	-	-
	% Personal loan from a bank	0	2	0	0	-	-	-	-	-
	% Blacklisted (own perception)	23	15	44	25	-	-			
Use of finance	% Who used loan from financial institution to purchase property	0	26	29	75			< 12%		
	% Who used own money	100	70	62	25	-	-	61-82%		
	% Who would finance new stock with a loan from a bank	79	58	69	50	-	-	-	-	-
	% Who believe it will be difficult to get a loan	79	58	69	50	-	-	-	-	-



Most Township Landlords who built units used **their own savings to finance it**. Other forms of finance used included retrenchment packages, stockpiling and pension/life policies. Less than 12% of all Township Landlords used a loan to build their unit.

Both Landlords and Service Providers identified (in the focus group discussions and interviews) a **reluctance to use the house as collateral in Townships**. In the focus groups a number of respondents indicated that they were not prepared to use the house as security, as the house could be repossessed if they default on their payments. They are dependent on the tenants paying their rentals.

### **3.1.7.2 Funding and support for Small Scale Landlords**

The Literature Reviews (See Resource Reports 1 and 2) and the Interviews with Service Providers (see Resource Report 8) identified the following funding organisations and initiatives (set out in Table 11 below<sup>24</sup>) currently available in respect of rental housing stock.

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<sup>24</sup> Adapted from South African Rental Sector Overview, David Gardner, 2005

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Table 11: Funding framework and support initiatives

Category	Initiative	Details
<b>Rental Finance Initiatives</b>	<b>Commercial Finance Providers</b>	<p>Commercial Financial institutions have found providing finance to Small Scale Landlords to be risky, costly and unprofitable<sup>25</sup>. As a result the development of financial products and services to this market have been limited, in addition Financial Institutions are extremely risk averse when offering these products. Key problem areas include:</p> <ul style="list-style-type: none"> <li>- Poor understanding of both Township and Inner City rental markets by Financial Institutions.</li> <li>- Operational split in that Banks do not have an appropriate Department that will deal with Small Scale Landlords</li> <li>- Few Banks have specific products for Small Scale Landlords</li> <li>- In specific areas (for example Townships), most will only provide finance if the Borrower provides sureties or assets 'outside of the project area'</li> <li>- Finance is provided to purchase the unit only and not refurbish it.</li> </ul> <p>The type of financial products available include micro loans and end user finance using different types of securitisation including for example pension fund surpluses, payroll deduction, mortgage over a property etc.</p> <p>The Financial Sector Charter aims to bring private financial institutions into the low income housing sector and may result in more finance being made available.</p>
	<b>NHFC Alternative Tenure Division</b>	<p>The National Housing Finance Corporation (NHFC) is a public company wholly owned by Government to increase the number and type of institutions that provide housing credit to low income earners. The NHFC provides wholesale financing to TUHF and other small loan institutions for on-lending to Landlords. In addition NHFC lends directly to rental entrepreneurs (both private and social housing institutions) for the purchasing, refurbishment and development of rental stock. NHFC is interested in growing its private rental lending portfolio across the country.</p> <p>Some Landlords have indicated that access to NHFC loans is difficult due to the loans being unaffordable and inflexible.<sup>26</sup></p>
	<b>NURCHA</b>	<p>The National Urban Reconstruction and Housing Agency (Nurcha) is a non profit Section 21 Company aimed at facilitating low cost housing development. Nurcha provides wholesale finance to TUHF (see below) and also has a rental lending programme where it directly provides finance to entrepreneurs for rental housing projects for refurbishments, conversions and new development. Nurcha is interested in expanding its rental lending portfolio in the inner cities of South Africa's major urban areas, as well as providing loans to backyard Landlords in Townships.</p>

<sup>25</sup> Resource Report 2

<sup>26</sup> K Rust, Investigation into constraints on the delivery of rental housing in South Africa, 2001

Category	Initiative	Details
	<b>Trust for Urban Housing Finance (TUHF)</b>	The Trust for Urban Housing Finance (TUHF) is a Not for Profit development finance company aimed at providing short and medium term loans to existing and future property entrepreneurs to finance the purchase of or improvement to buildings for residential rental. Although a primary goal is to contribute cost-effective and cost-efficient solutions to the regeneration challenge facing these areas, the organisation will only finance projects that are viable as sustainable business ventures. TUHF provides finance to small private owners, small private residential landlords, institutional housing developers and Social Housing Institutions. TUHF provides both bridging finance and long term loans. This is the only funder that provides finance specifically for Small Scale Landlords. (For more details on the products offered see box)
	<b>Gauteng Partnership Fund</b>	The Gauteng Partnership Fund is a trust established by the Gauteng Department of Housing, with the purpose of enabling social housing associations in Gauteng to obtain financing at the most favourable terms. It offers a range of finance products to Social Housing Institutions. It is currently developing a product focused on Small Scale Landlords offering backyard accommodation.
<b>Support services</b>	<b>Support services focused on Bodies Corporate</b>	The following support services are available to Bodies Corporate that are experiencing problems: <b>Bailing out Ailing Bodies Corporate:</b> A service provider engages with dysfunctional Sectional Title schemes, with the aim of getting them to operate again. <b>Body Corporate Takeovers:</b> Clauses in Sectional Title bonds allow Banks to take up the vote on behalf of financed units at any stage. They then appoint a Service Provider to provide assistance to the Bodies Corporate. <b>Judicial Administration:</b> Ian and Neville Schaffer have developed an approach to “turning around” ailing Bodies Corporate. 11 buildings are under their administration at present.
	<b>YDL</b>	YDL is an independent property investment training entity that provides a range of education/information programmes aimed at generating interest from emerging entrepreneurs in rental property. All programmes combine theory and practical elements with inputs from industry experts.

Category	Initiative	Details
<b>Grant funding</b>	<b>The Institutional Subsidy</b>	<p>This subsidy was introduced as part of the Governments national housing subsidy scheme in 1996. The subsidy is made available to institutions who undertake approved projects, that offer rental or instalment sale housing units to beneficiaries.</p> <p>The Institution needs to be established as a legal entity and need to identify a housing project to be undertaken. Such a project can either be a new development or the upgrading of existing housing stock. The stock is provided in such a manner that the stock can be converted from rental to ownership after a 4 year period.</p> <p>The subsidy will be amended in terms of the Comprehensive Plan for the Development of Sustainable Human Settlements. In this regard a new subsidy mechanism is to be introduced to facilitate the availability and accessibility of affordable housing finance products/instruments to medium income households earning between R3,500 to R7,00 per month by providing a mechanism to overcome the down payment barrier. In addition the 3 subsidy bands currently in place are to be collapsed to enable households earning below R3500 to access a uniform subsidy amount.</p>
	<b>Overseas grants in aid</b>	A number of overseas donor agencies provided grants or loans to Social housing Institutions.
<b>Rental Guarantee Initiatives</b>	<b>Gauteng Rental Guarantee Fund</b>	The Gauteng Rental Guarantee Fund is administered by Nurcha to underwrite finance provided to rental institutions. It operates as a credit enhancement tool to leverage long term development finance for rental housing projects.
	<b>Home Loan Guarantee Company Guarantees</b>	<p>The HLGC offers two guarantees:</p> <ul style="list-style-type: none"> <li>- A bond guarantee</li> <li>- A guarantee that covers the cost of lost income due to tenants of rental institutions meeting with unforeseeable economic hardship.</li> </ul>

Interviews with Service Providers operating in the rental sector (see Resource Report 8) identified the following key challenges:

- An insufficient number of entrepreneurs
- Limited availability of stock as a result of increasing costs
- Limited availability of finance and most finance is not tailored to the need of the specific type of business operated by Small Scale Landlords (the only financier who provides tailored finance is TUHF (see box))
- Entrepreneurs do not have sufficient equity.
- Key factors pertaining to the role of Government increase the risks within the sector including:
  - Local Government capacity problems resulting in the breakdown in administrative payments in respect of rates payments and clearance certificates

- The Prevention of Illegal Eviction and Unlawful Occupation of Land Act, (1998) (PIE ) has not been amended
- Flat hijackers in the Inner City which are not effectively addressed by the South African Police Services.
- Many entrepreneurs lack management expertise which affects their viability (for example collections, tenant origination and checking, default management, evictions and security)
- Non performance by Body Corporates which undermines any investment made in the building.

The findings of the international research (see Resource Report 2) emphasises that when **making finance available to Small Scale Landlords** ‘credit-plus’ lending strategies are important. Such strategies **couple together the provision of finance with business support services. With the exception of TUHF** there are no examples of local lenders using ‘credit plus’ strategies.

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**Financial services provided by TUHF**

**Loans to Rental Entrepreneurs:** TUHF provides area-based financial support in the form of loan finance to emerging and existing landlords within Region 9 in Johannesburg. The loans are provided predominantly to smaller-scale rental entrepreneurs for building refinancing, building purchase, building refurbishment, building conversion or greenfields construction. TUHF makes loans available of below R10-million (recently raised from R5-million maximum), right down to financing needs for 3-plex or 4-plex structures. The largest loan made to date is R8,2-million and the smallest R150 000. In providing these loans TUHF assists entrepreneurs to develop business cases and to manage the finance granted.

TUHF remains committed to its Johannesburg Inner City focus area (essentially Region 9), but will consider applications that fall close to this boundary. Currently, TUHF is assessing the prospects offered by the Pretoria, Durban and Port Elizabeth inner-city areas TUHF has recently raised almost R300-million from various funders (including Nurcha and the NHFC), which they believe they will be able to lend out relatively quickly.

**Direct Support: Equity Facility:** TUHF has recently set up an Equity Facility with the Gauteng Partnership Fund that enables it to make equity placements (through subordinated loans) in certain projects of up to R200 000 per project up to a maximum of 20% of total project cost.. Currently one project is in place and one is nearly concluded.

**Other Support:** TUHF has a very thorough loan origination and monitoring approach based on “understanding your market”. Their geographic focus implies that they are well aware of market conditions in the areas they operate. Types of support include technical information, access control information, building design input and financial advice.

A number of international case studies were reviewed (for details see Annexure A). On the basis of these the following common factors were identified in respect of best practice when lending to Small Scale Landlords:

- Lending should only occur where there are **profitable and viable markets**.
  - Entrepreneurs should have the **necessary skills to undertake the work and the entrepreneurial drive**.
  - **Engagement with other producers** in the sector should be encouraged.
  - **Key constraints in the economic chain** should be identified and removed
-

- **Client education and counselling** should be an integral part of the loan process providing **appropriate and affordable business development and support services**. Support should be provided by skilled staff who specialise and are **knowledgeable of the sector** in which the entrepreneur operates. Entrepreneurs should be assisted in sharing market information, technical know how and information.
- Loans should be **tailored to meet the cash flow needs** of the borrower.
- Loans should not be made on the basis of the applicants ability to repay the loan from salary, rather the primary focus in approving the loan should rest on **expected cash flow and the character of the applicant**.
- In order to ensure that the loan is repaid timeously it is important that the Lender **‘knows the customer’**. Accordingly an operating office should be located amongst the client base and should have continuous contact with the Borrower. The Lender should have an **understanding of the goals of the borrower and the market in which s/he is operating and be focused on assisting the borrower to succeed**.
- **Community organisations** can be used as a platform to sell and market the loan products.
- Borrowers should provide **upfront collateral**.
- For Landlords and Entrepreneurs who are expanding their assets progressively, large **traditional loans are not well suited to their more incremental** needs. A mix of finance from various sources such as savings, loans from family and friends and small loans are being used to overcome problems associated with longer term formal finance.

Given the above it can be concluded that:

- A number of policy **and funding initiatives are being implemented** to assist with the development of the sector. However despite this there is a **lack of loan finance, particularly in respect of the private sector low income rental sector and Small Scale Landlords**. The reason for this is as follows:
  - **Commercial Banks remain extremely risk adverse.**
  - **Other Development Finance Institutions focus either on Social Housing Institutions or provide finance in a manner that is inappropriate or is difficult to access**<sup>27</sup>

The most effective source of funding is that provided by TUHF, which **has a specific focus on providing finance for small scale private sector Landlords** (see box).

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<sup>27</sup> K Rust, Investigation into the constraints on the delivery of rental housing in South Africa, 2001

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- International experience indicated that making finance available to Small Scale Landlords should occur on a **‘credit-plus’ basis** where finance is coupled with business support services, which are provided on an ongoing basis.
- Loan products that have been developed rely on traditional forms of security and lending procedures. In addition there is a lack of specific loan products designed for Small Scale landlords. This means that such Landlords wishing to access finance do so **by combining various sources of capital such as savings, borrowings from friends and family, small unsecured micro loans and formal loans.**
- The **revised subsidy proposals may offer opportunities** for Small Scale Landlords however the nature of the subsidy needs to be determined.
- The **Financial Sector Charter could benefit Small Scale Landlords** and provide funding for the purchasing of rental stock.

### 3.1.8 Regulatory and policy environment

**There is a range of legislation that pertains both generally and specifically to Small Scale landlords. The survey undertaken into Inner City Landlords found that such Landlords are generally unaware of the regulatory requirements to which they should adhere and to legislation that impacts on them. This issue was not surveyed in respect of Township Landlords but anecdotal evidence indicates that a similar lack of awareness would apply.**

#### 3.1.8.1 Regulatory and policy environment

There is a range of legislation pertaining to the rental sector in South Africa impacting on:

- The establishment of a legal operating structure
- Governance of the structure
- Method of operating
- Taxation

An overview of this legislation can be seen in Annexure B attached. Table 12 below highlights some of the legislation that has a significant bearing on rental housing as provided by Small Scale Landlords in South Africa.

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Table 12: Legislation that impacts on small scale Landlords in South Africa<sup>28</sup>

Legislation	Details
Residential Landlord Tenant Act, 1997 (Gauteng)	This Act deals primarily with landlord tenant relationships and was enacted in Gauteng to deal with the instability in the rental housing market in the inner cities and particularly in Johannesburg city centre. The Act essentially provided for dispute resolution mechanisms and for regulations relating to so-called unfair practise.
The Rental Housing Act, 1999	<p>The Rental Housing Act was introduced to provide a national framework for rental housing. Many of its provisions correspond with the provisions of the Gauteng legislation referred to above. The Act, however was also aimed at creating a more general legislative framework within which rental housing could be stabilised and facilitated. The Act envisages rental housing legislation at the provincial level, failing which the back up provisions of the Act would apply unless replaced. Key provisions of the Act are as follows:</p> <ul style="list-style-type: none"> <li>- Government must provide a stable and growing market that progressively meets the latent demand for affordable rental housing among persons historically disadvantaged.</li> <li>- Government must facilitate the provision of rental housing in partnership with the private sector.</li> <li>- The Act allows for the establishment of a Rental Tribunal to rule on disputes between landlords and tenants.</li> </ul>
Urban Renewal Tax Incentive, 2005	<p>The Urban Renewal Tax Incentive took effect on the 6 June 2005 and is published in the government gazette no 27656. The incentive is available for 16 municipalities in terms of the Revenue Laws Amendment Act, no 45 of 2003.</p> <p>As of June 2005, 13 municipalities have been approved to participate including Polokwane, Nelson Mandela, Ekurhuleni, eThekweni, Tshwane, Buffalo City, Mbombela, Mangaung, Sol Plaatje, Emfuleni, Johannesburg and Cape Town. The Municipalities have been declared Urban Development Zones and the tax incentive is offered to stimulate investment in the inner city areas of these zones. An accelerated depreciation allowance is provided aimed at promoting refurbishment and new construction. For the refurbishment of existing buildings, investors are eligible to receive a 20% tax deduction in the first year of earning income, plus an annual depreciation of 20% over a four year period. For new developments, this incentive offers a tax deduction of 20% in the first year, plus an annual depreciation of 5% for the next 16 years.</p>

<sup>28</sup> Sigodi Marah Martin and Matthew Nell and Associates Joint Venture, Resource File, 2002

Legislation	Details
<p>A comprehensive plan for the development of sustainable human settlements: Breaking New Ground</p>	<p>This plan was approved by Cabinet on the 2 September 2004 and provides the overall strategic framework for housing programmes in South Africa for the next five years. The plan aims at ‘promoting the achievement of a non-racial, integrated society through the development of sustainable human settlements and quality housing’ through supporting the entire residential property markets. The key components of this plan include the following:</p> <ul style="list-style-type: none"> <li>- Informal settlements will be integrated into the boarder urban fabric to overcome spatial, social and economic exclusion. The DOH will accordingly introduce a new informal settlement upgrading instrument to support the focused eradication of these settlements.</li> <li>- Previously excluded groups will be integrated into the cities and more integrated, functional and environmentally sustainable settlements will be ensured through a densification policy, residential development permits (which will require developers to either set aside units within residential developments for lower income groups or develop lower income residential accommodation in adjacent areas) and fiscal incentives.</li> <li>- Enhancing spatial planning through greater coordination and alignment of various planning instruments and economic policies.</li> <li>- Enhancing the location of new housing projects through accessing well located state owned and parastatal land, acquisition of well located private land for housing development, providing funding for land acquisition and fiscal incentives.</li> <li>- Supporting urban renewal and inner city regeneration through encouraging social medium density housing and increasing effective demand by providing finance to households earning between R3 500 and R7 500. As part of this programme backyard rental accommodation is recognised as an important component of the overall private sector and an appropriate policy needs to be developed for this form of rental accommodation.</li> <li>- Developing social and economic infrastructure by providing funding for the construction of social and economic infrastructure to be developed by Municipalities.</li> <li>- Enhancing the housing product through improving settlement and house design and improving the quality of housing (built and still to be developed).</li> </ul> <p>The detailed strategies of the plan have been developed into 7 Business Plans each addressing a different area.</p>

In addition to the above legislation, there are a number of initiatives that are being implemented aimed at facilitating rental housing in South Africa. These include:

- **Top Twenty Township Programme:** This Programme is being implemented by the Gauteng Department of Housing and is aimed at rehabilitating townships that are under resourced with social and economic amenities.
- **Backyard Rental Policy:** This policy was developed by the Gauteng Department of Housing aimed at upgrading the existing backyard rental housing stock in Gauteng. The policy is still in draft form.
- **Provincial and Metropolitan Housing Departments:** A number of Departments are undertaking research into the rental sector. Some are actively including this sector in strategy documents.
- **Rental Lobbying Bodies and research organisations:** The Social Housing Foundation, the National Association of Social Housing and research related organisations like the Finmark Trust are undertaking research focused on the rental sector.

Legislation that has a negative impact on the rental sector or is not supportive includes:

- **Value Added Tax Act, 1991:** The provision of residential accommodation is neither vatable nor is a claim of input VAT. This results in a funding and cash flow cost which impact negatively on the cost of provision of rental housing stock.
- **Income Tax Act:** Institutions upgrading or converting existing stock cannot access tax exemptions
- **Prevention of Illegal Eviction and Unlawful Occupation of Land Act, 1998 (PIE):** PIE results in a fiscal burden on behalf of landlord-owners as they have to find alternative accommodation for non paying occupants of buildings (including invaders and defaulting tenants) where they have been in the building for more than six months.

Government attitude towards rental tenure especially in respect of Small Scale Landlords is mixed. While there is an increasing recognition of the value of this form of housing provision within the policy itself, this is not necessarily reinforced in terms of the attitudes of leading officials and politicians. For example MEC Nomvula Mokonyane is reported in the Star in July 2005 as saying that ‘ the government builds houses for people to live in, not to rent or erect shacks in their yards’. This was as a result to a visit to Kagiso on the East Rand where she determined that some residents were renting out their RDP houses, while others had erected more than one shack in their backyards to let to tenants.

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Given the above it can be concluded that :

- The legislation adopted to date has focused on the **stabilisation of inner cities and landlord tenant relations** as opposed to the **facilitation of the development of rental stock**.
  - The legal system and the Rental Act are **ineffective in providing incentives for tenants to pay for their accommodation and apply sanction in cases of non payment**. The Rental Tribunal has insufficient capacity to carry out its own recommendations. PIE further exacerbates this problem. This results in some landlords by-passing the legal system altogether.
  - The impact of the Urban Renewal Tax Incentive in the Urban Development Zones **does offer opportunities** for Landlords who are upgrading or building rental buildings in the designated areas.
  - The Comprehensive plan for the development of sustainable human settlements **may provide opportunities for small scale landlords in terms of encouraging mixed used areas and medium density housing programmes**.
  - Household rental has only started to be formally acknowledged in policy terms and policy in terms of supporting Landlords providing this form of accommodation is beginning to be formulated. The Backyard Rental Policy being formulated by the Gauteng Department of Housing is to be welcomed. This is an **opportunity** in respect of small scale Landlords owning this form of rental stock.
  - Initiatives like the **Top Twenty Townships Programme are an opportunity** in that they focus on upgrading the urban form of townships areas thereby making them better places to live and increasing their attractiveness as areas for rental accommodation. Such initiatives could also result in increasing rentals which could have both positive and negative consequences.
  - The provision of the **Value Added Tax Act**, relating to the development of rental housing presents impediments to implementing rental housing projects
  - Exemptions permitted in terms of the **Income Tax Act** do not provide for landlords upgrading or converting existing stock.
  - **Government attitudes** towards the rental sector especially small scale landlords offering backyard rental accommodation is mixed.
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### 3.1.8.2 Knowledge and compliance

On the basis of the survey of Inner City Landlords (See Resource Reports 5), Table 13 below provides an overview of the extent to which Small Scale Landlords comply with existing legislation and regulation. This issue was not surveyed in respect of Township Landlords but anecdotal evidence suggests that the findings would be similar.

Table 13: Issue pertaining to the regulatory and policy environment: Inner City Landlords

Characteristic	Measure	1 Unit	2+ Unit	Sub-letting	Building	Managing Agent	
						Unit	Building
<b>Compliance</b>	% who's business is not registered as a business	86	90	96	0	-	-
	% who's business is registered as a sole proprietor/private company	2	5	2	50	-	-
	% who do not pay income tax	91	97	98	0	-	-
<b>Knowledge of policy initiatives</b>	% who have heard of UDZ tax incentives	13	3	3	0	-	-
	% who have not heard of the Rental Housing Act	93	87	96	50	-	-
<b>Rental Tribunal</b>	% who have been to the tribunal	6	3	6	25	-	-
	% who felt they were treated fairly	100	100	100	100	-	-
<b>Role of Local Govt</b>	% who have not found Local Govt to be helpful to their business as a Landlord	69	54	66	50	-	-
	Ways in which Local Govt helps or constrains the business as a Landlord (in order of priority)	Not sure/don't know Fails to keep place clean Don't want to give us a chance to make money No support in terms of loans				-	-

On the basis of the above it is evident that there are low levels of knowledge and compliance of existing legislation as follows:

- **Compliance:** Most Subletting and Unit Landlords are not compliant. Most (above 86%) are not registered as a business and most (more than 91%) do not pay income tax. This is less the case with the Building Landlords where 50% are registered and all pay income tax.

- **Knowledge of policy initiatives:** Most Landlords have not heard of recent policy initiatives. Less than 13% have heard of the UDZ tax incentive and less than 13% have heard of the Rental Housing Act in the case of Subletting and Unit Landlords. Half of Building Landlords had heard of the Act.
- **Rental Tribunal:** Use of the Rental Tribunal is limited (less than 6% in respect of Subletting and Unit Landlords). However of the few that went to the Rental Tribunal all felt that they were treated fairly.
- **Local Government role:** Over half of Landlords feel that the Local Government has not been helpful to their business as a Landlord. Many though did not know how the Local Government could help them. Constraints to their business included not keeping the place clean and not providing support in terms of loans.

### 3.1.9 Successful Small Scale Landlords

Qualitative in-depth interviews were undertaken with 20 'Successful' Landlords to complement the primary research undertaken into Small Scale Landlords (see Resource Report 7). The 20 Landlords interviewed were categorised into the following types:

- Township Landlords
- Unit Landlords
- Building Landlords
- Building plus Landlords

The findings of the research shows a high degree of similarity with the primary research undertaken into Landlords in Inner City Areas and Townships. In addition the research shows that the above types of Landlords operate differently and need different levels of support:

- **Township Landlord:** These Landlords use their own finance. Generally they are not able to access financial support from Financial Institutions. The quality of their stock is problematic in some instances. They manage and maintain the stock by themselves. They have strong personal relationships with their tenants. They operate their businesses on an informal basis with very limited formal agreements. These Landlords require financial support to expand and improve the quality of the stock. In addition there is a strong need for business support to improve the basis on which they manage their business.
-

- **Small Unit Landlords:** These Landlords generally have a limited number of units (less than 50). They manage the stock themselves. Maintenance is outsourced to a private contractor. They have personal relationships with their tenants. The Business is operated on a very informal basis with limited use of formal agreements. Access to finance is better than in respect of the Township Landlords but is limited to personal loans. Such Landlords are not able to access business loans. Thus they will only be able to access loan finance to the extent that their personal collateral and income will allow. These Landlords need assistance to increase the amount of finance that they can access. They also need business support to improve the basis on which they are managing their stock.
- **Larger Unit Landlords, Building Landlords and Building plus Landlords:** These Landlords operate their businesses on a formal basis with written agreements and clear management procedures. Their ability to access finance is better than other Landlords.

#### 3.1.10 Public Sector Stock

**Public Sector stock was reviewed to determine the feasibility of applying an approach whereby such stock is transferred to Small Scale Landlords. On the basis of a review of the current status of such stock and two case studies it is determined that Small Scale Landlords are unlikely to be a key mechanism for addressing hard to sell public sector stock without considerable investment by the State.**

**The purpose of this component of the research was to obtain an understanding of issues pertaining to Public Sector owned stock to determine the feasibility of applying an approach whereby such stock is transferred to Small Scale Landlords.**

This section provides background to State Owned Stock in South Africa and then outlines a detailed scoping of two case studies so as to obtain an understanding of the challenges and opportunities that this stock provides in respect of Small Scale Landlords. This section then sets out key conclusions.

The two case studies scoped are the Provincial Flats in Alexandra Far East Bank and Sonof Flats in Emfuleni. The case studies were selected because they provide two extreme examples, with the one (Provincial Flats, Alexandra) facing considerable challenges, as opposed to Sonof Flats which is operating relatively effectively.

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In selecting the case studies the focus was on housing stock currently owned by a Public Sector Body, that would be appropriate for Small Scale Landlords. Whether or not the stock qualified in terms of the transfer of housing scheme was not a priority and it is noted that the Provincial Flats in Alexandra Far East Bank fall outside of the criteria having been built after 1994. It is likely that the Alexandra Flats would qualify for the EEDBS.

#### **3.1.10.1 Background**

Public Sector rental housing stock was developed by Government to provide subsidized housing to low income households. The type of housing provided was detached housing units, row or other forms of attached houses, flats or multi-storey dwellings and Hostel accommodation.

The housing stock was initially funded through subsidised loans provided by the National Housing Fund. Such loans are no longer available. Ongoing operational costs are funded through operational budgets of the managing sphere of Government.

Generally no new stock is being developed. Existing stock is being disposed of through the Sale and Transfer of Housing Stock policy promulgated as part of the National Housing Act. Subsidisation is provided to facilitate this process through the Discount Benefit Scheme. This process has been underway for more than a decade.

In December 2006 the National Department of Housing approved a new policy framework and implementation guidelines for the Enhanced Extended Discount Benefit Scheme (EEDBS). The EEDBS replaces all other policies and implementation guidelines relating to the Discount Benefit Scheme and the phasing out programme for public sector stock. The aim of the EEDBS is to stimulate and facilitate the transfer of public housing stock to qualifying occupants, by using subsidization up to the full prevailing individual housing subsidy amount (for details see box).

The EEDBS focuses predominantly on the transfer of stock to individual beneficiaries. While rental stock in the form of clusters, row houses and flats are considered, it is in the context of sectional title transferred to individuals in respect of one unit, rather than to private sector Landlords.

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As at June 2005 it is estimated that a total of 600 000 units have been transferred as part of the transfer of stock process. It is difficult to determine precisely the number of units still to be transferred. The best estimate is that there are approximately 200 000 units still to be transferred of which:

- 90 000 to 100 000 units is stock managed by Provincial Housing Departments
- 80 000 to 100 000 units is stock managed by Municipalities and Local Government bodies
- 5 000 to 10 000 units is stock managed by Parastatal or state corporate bodies.

Of this stock however it is estimated that a high proportion will be difficult to transfer as a result of the following reasons:

- It is in poor physical condition
  - It is in a poor location
  - There are multiple claims for ownership
  - The units are attached and require joint management of shared areas.
-

**Enhanced Extended Discount Benefit Scheme (EEDBS): Key components**

- **Qualifying criteria:** A beneficiary must be a natural person who:
  - Has a direct housing arrangement with the State
  - Has benefited from specified housing subsidies, programmes or schemes
  - Has an outstanding debt with a Municipality or Province
  - Is considered competent to contract
  - Has a legally binding contract with the relevant authority
  - Is a de factor tenant or is occupying the housing unit
- **Applicable housing stock:** Housing stock applicable includes State finance housing units constructed or contracted on or before the 15 March 1994. Post 1994 occupants of units will be considered in specific circumstances or at the discretion of the relevant housing authorities.
- **Calculation of sales price:** The calculation of the sales price includes the balance of the capital still be paid based on the listed selling price or historic cost of the property plus improvements and other arrears that have accrued to the occupant. In respect of multiple units, the real cost of maintenance, repair and administration of multiple unit blocks must be taken into account.
- **Payment for the stock:** The full prevailing individual housing subsidy amount will be applied to the sales price for qualifying beneficiaries in terms of the income category allocation applicable to the beneficiary. Persons who earn R7000 per month will receive R7 500. In instances where the selling price is greater than the EEDBS, any balance remaining must be financed, by using the beneficiaries own resources, which may include mortgage loans.
- **Multiple units:** In respect of Multiple Units (flats, cluster homes and row houses) Public sector owners must be realistic about the possibility of any block being suitable for making a sectional title offer and must be in line with the Sectional Title Act. If the housing stock is not suitable the tenants should be told why they cannot receive the EEDBS. If the stock is suitable for conversion, and the relevant authority has decided and approved the suitability of the project, then an offer should be prepared, in consultation with the tenants and in compliance with applicable statutory requirements. The offer should be open for a limited time with the proviso that the project is viable and consultation has taken place with the relevant authority and role players.
- **Process to be applied:** The following process will be applied:
  - **Normalisation:** Identifying the relevant housing stock and its condition: This component comprises identifying the stock, the number of housing units, the condition of the stock, and determining any arrears accruing.
  - **Regularisation:** This component comprises determining the entitlement of the occupants and other persons to a housing unit and the EEDBS. In this regard tenure rights must be considered, as well as a thorough and transparent enquiry procedures including community involvement where appropriate.
  - **Relocation:** It is noted that where households have a legal claim to the housing unit in which they live but are unsuitable (due to non-affordability or other reasons) or do not qualify as occupants of the housing unit the relevant authority is required to assist the occupants to find alternative accommodation.
  - **Individuals who do not wish to participate:** Existing contracts with individuals who do not wish to participate, whether rental or sales agreements must be honored.
  - **Rectification:** Once the stock has been normalized and regularized a decision need to be taken on whether the housing stock should be repaired to the point where it is safe and habitable.

### 3.1.10.2 Case Studies

Two case studies are scoped namely Provincial Flats in Alexandra Far East Bank and Sonof Flats in Emfuleni. A summary of the findings is shown in Table 14 below.

Table 14: Case Studies Scoped

Case Study	Overview	Key findings
Provincial Flats: Alexandra Far East Bank	<ul style="list-style-type: none"> <li>- 151 flats</li> <li>- Funded by DOH</li> <li>- Units illegally invaded</li> <li>- Units only partially completed and have inadequate services</li> <li>- Not under any form of management</li> <li>- High levels of overcrowding</li> </ul>	<ul style="list-style-type: none"> <li>- Flats well located</li> <li>- Effective demand for the units is limited unless rentals are restructured to meet affordability limitations</li> <li>- The flats are in a very poor condition and pose a health hazard to the occupants</li> <li>- Extensive refurbishment will be required- estimated cost R5,8 million</li> <li>- Assembly of property would require active participation of authorities – as occupants will need to be relocated</li> <li>- At current rentals the COJ will have to make a capital contribution of between R1 to R2 million</li> </ul>
Sonof Flats, Vereeniging, Emfuleni	<ul style="list-style-type: none"> <li>- 78 units – 3 storey walk up</li> <li>- Emfuleni Municipality registered owner</li> <li>- Arrears on rentals high</li> <li>- Tenants primarily pensioners and indigent</li> <li>- Building in reasonable state of repair but no maintenance being undertaken</li> </ul>	<ul style="list-style-type: none"> <li>- Building in reasonable state of repair- needs some short term maintenance</li> <li>- To dispose of building all tenants need to be informed and those who cannot afford higher rentals relocated.</li> <li>- Estimated assembly cost is R0,77 million.</li> <li>- Building could be easily transferred to a Small Scale Landlords with relatively minimal cost to the Municipality</li> </ul>

### 3.1.10.3 Appropriateness for Small Scale Landlords

On the basis of the review of the current status of Public Sector stock and of two case studies it is concluded that Public Sector stock could only be appropriate for Small Scale Landlords if the properties are sold to such Landlords who then operate them on free market principles. For this to occur a number of issues must be resolved:

- The rights of the tenants living in the building to take transfer of their units.
- The political will and ability of the Public Body owning the stock to relocate those tenants who cannot afford increased rentals.
- The state of the physical structure, which in many cases is in poor condition and needs substantial upgrading.

Some Public Sector Stock will not be suitable for sale due to poor location or the lack of a market willing to pay sustainable rentals.

Generally it can be concluded that Small Scale Landlords are unlikely to be a key mechanism for addressing hard to sell State Owned Stock without considerable investment by the State. There may be some stock (for example Sonof Flats) that is appropriate for Small Scale Landlords. The key criteria for this would be:

- Good location
- The building is in reasonable physical state and/or the relevant Government authority is willing to provide the capital to upgrade the stock into a reasonable state
- Most of the tenants in the building can afford increased rentals and are willing to remain tenants rather than become owners in a sectional title scheme as envisaged by the EEDBS
- The relevant Government authority is willing to relocate those tenants who cannot afford increased rentals.

### **3.1.11 Conclusion: Small Scale Landlords**

**(1) Importance of Small Scale Landlords: Small scale landlords make a significant contribution to the South African economy:**

- Firstly through the **provision of a range of accommodation types** for approximately 15% of all South African households (1,85 million households). Of this stock, 60% (1,1 million households) comprises Household Rental including both formal and informal units located in backyards. Generally this accommodation is well located and affordable to very poor households (earning R1 800 per month on average).  
Small Scale Landlords are therefore enhancing the conditions of poor people by contributing significantly to the supply and management of affordable rental housing.
  - Secondly the Small Scale Landlord sector provides a **critical opportunity to promote income generation and wealth creation for Small and Medium Enterprises (SMEs)**. It is estimated that the sector is generating rental income of approximately R421 million per month.
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There is **potential for growth** within the sector. Demand for stock appears high and most Landlords in both Inner Cities and Townships indicated that it is easy to find tenants (over 62%). Township Landlords report that the number of tenants coming and asking for a place to rent is at a rate of 6-12 people per month and that vacancy is effectively zero. However this potential is **currently not being realised to its fullest potential**. The overall rental sector saw a decrease in its percentage size within the overall Housing Sector between 1999 and 2005. Of greater concern is a decrease in the number of households living in formal rental accommodation during this period.

Given the context of South Africa with a significant housing shortage, high levels of poverty and unemployment and a strong focus on enterprise development it is evident therefore that **there is a need for and value in supporting the growth of the Small Scale Landlord sector**.

(2) **Differences between Small Scale Landlords: While there are some similarities, Inner City and Township Landlords and their rental stock are different:**

- **Inner City Landlords** are generally **formally employed, well educated and male**, offering formal rental accommodation predominantly in the form of flats.
- **Township Landlords** are generally **poor, aged and female**, offering a mix of formal and informal rental accommodation (often of poor quality) in the form of attached and detached units.

Inner City Landlords can be categorized into five types:

- **Sub-letter landlord:** A Landlord who has legal title to a unit, a portion of which is rented out where the relationship with the tenant is direct, the Landlord stays in the unit and the unit is formal.
  - **One (1) Unit Owner:** A Landlord who has legal title to one unit that s/he rents out on a basis where the relationship with the tenant is direct, the Landlord does not stay in the unit and the unit is formal.
  - **Two plus (2+) Unit Owner:** A Landlord who has legal title to two or more units (but less than a building or 200 units) on a basis where the relationship with the tenant is direct, the Landlord does not stay in the unit and the unit is formal.
-

- **Building Owner:** A Landlord who has legal title to a building with residential units that s/he rents out to tenants on the basis where the relationship with tenants is direct and the units are formal. As the research focused on Small Scale Landlords this category of Landlords was restricted to Building Owners that own less than 200 units.
- **Landlord that uses a Managing Agent:** This category of Landlords uses a Managing Agent on the basis where the Landlord does not have a direct relationship with his/her tenant.

There are differences between these categories of Inner City Landlords, each having different characteristics in respect of how they operate and the challenges that they face.

All of the Landlords in Townships are Unit Owners, with a very small number being Sub-letter Landlords. Townships Landlords are further categorised in respect of the type of unit and who built the unit. Three categories of Landlord are identified:

- **Formal Unit Landlord:** Defined as a Landlord who has a formal unit.
- **Informal Unit Landlord:** Defined as a Landlord who has an informal unit
- **Tenant Unit Landlord:** Defined as a Landlord where the tenant erected the unit and is renting a portion of the Landlord's land

Clear geographic differences were shown between the different type of Township Landlords in the areas surveyed. This indicates that there are geographic factors that strongly influence the type and nature of the rental market that occurs in a particular area.

**Given the above, the application of policy, provision of funding and other support must occur in a manner whereby the specific differences between the different types of Landlords are understood and taken into account.**

- (3) **Entrepreneurship: Not all Landlords are entrepreneurial and only some of them are investing and taking risk and wanting to expand their rental portfolios** (for example only 40 to 45% of Unit Owner Landlords are motivated by the investment). This is particularly evident with respect to Township Landlords where there is a clear distinction between **subsistence Landlords**, who are generally pensioners using the rental income to augment pensions and **entrepreneurial Landlords**, who are generally
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younger people wanting to pursue landlordism as a means of earning primary income or augmenting existing income.

The data further suggests that a **ladder of growth could be occurring**, particularly in respect of Inner City Landlords, whereby as more entrepreneurial Landlords become successful in a particular category and acquire more income and experience, they move to the next category thus moving from subletting, to 1 unit, to 2+ units, to a building owner<sup>29</sup>. However if the prevalence of the types of Inner City Landlords is considered, where Sub-Letting and 1 Unit Landlords are the most prevalent (38% and 23% respectively) it would appear that the transition from these types of Landlords to a 2+ Unit or Building Landlord is difficult. This could be the result of the lack of finance available to Sub-Letting and 1 Unit Landlords (see (4) below).

**The above implies that support to Small Scale Landlords could result in the more entrepreneurial of such Landlords both growing and improving their stock.**

(4) **Access to finance: The different categories of Landlords (see (3) above) access finance differently and have different needs and preferences with respect to finance. Small Scale Landlords that operate their businesses on an informal basis (see (5) below) have less access than those operating on a more formal basis:**

- Township Landlords, Subletting Landlords and Unit Owner Landlords mobilise considerable personal savings rather than formal business loans into acquiring stock. Access to financial products is generally poor. Just under one third of Sub Letting and Unit Landlords and fewer than 12% of Township Landlords accessed a loan from a financial institution to purchase their unit. Between 62% and 82% used their own money.

These types of Landlords have different needs and views of financial products. Generally Township Landlords are reluctant to use the house as collateral. Many Subletting and Unit Owner Landlords (between 58 and 69%) would like to access loan finance, but believe it would be difficult (58%-79%.) This type of Landlord is generally not able to access business loans (for example less than 18% have a current or cheque account) and is therefore restricted from growing their

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businesses through the limitation of their personal income, which is used as the basis for the provision of mortgage loans.

- Building Owner and Managing Agent Landlords are able to access loan finance (both personal and business) more easily. Approximately three quarters of Building Owner Landlords accessed a loan and approximately half have a current or cheque account.

The difficulty in accessing loan finance (particularly in respect of Township, Subletting and Unit Landlords) is due to the fact that Commercial Banks while offering loans are extremely risk averse. Other Development Finance Institutions (for example Nurcha and the NHFC) focus on Social Housing Institutions or provide finance in a manner that is inappropriate or difficult to access for Small Scale Landlords. The most effective current source of funding (although limited) is that provided by TUHF, which has a specific focus on Small Scale Landlords.

International experience indicates that making finance available to Small Scale Landlords should occur on a 'credit-plus' basis where finance is coupled with business support services, which are provided on an ongoing basis.

**Given the above it is evident that the different types of Landlords require different types of loan products. In addition that current loan products are not appropriate for Township, Subletting and Unit Landlords and new products need to be developed that are appropriate in terms of their markets and circumstances and provide both finance and business support.**

- (5) **Business support:** The competencies of Small Scale Landlords to manage their businesses varies in terms of the different types of Landlords and tasks to be undertaken.

Generally all categories in both Inner Cities and Townships are **very efficient at selecting and managing Tenants**. When selecting Tenants, as with other private rental markets, factors influencing the ability of the Tenant to pay the rental are taken into account by most Landlords in both Inner Cities and Townships. This results in low levels of non payment in respect of all categories of Landlords (less than 40% although

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<sup>29</sup> The Literature review indicates that Entrepreneurs do not move easily from one rung of the ladder to the next

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this is higher in respect of Building Owners). The relationship between the Landlord and Tenant is generally good (see (7) below).

**Generally Township Landlords, Subletting Landlords and 1 and 2+ Unit Owner Landlords operate on an informal basis, while most Building Owners and Managing Agent Landlords operate on a formal basis.**

Township Landlords, Subletting Landlords and 1 and 2+ Unit Owner Landlords generally:

- Do not take a deposit (50-82%), do not have written contracts (79-100%) and do not provide written invoices or receipts (54-77%).
- Manage the business themselves (62-100%) and collect rentals in cash (56-99%) or in the case of some Township Landlords in kind.
- Have not registered their business (over 86%), do not pay income tax (over 91%) and do not keep financial records (over 96%)

Building Owners and Managing Agent Landlords on the other hand generally:

- Use an agent who does take a deposit (100%), have written contracts (75-100%) and provide written invoices or receipts (100%)
- Rentals are paid into a bank account (77-100%)
- Business are registered (over 96%) and financial records are kept (over 96%)

**The amount of rental charged by and profitability of Small Scale Landlords appears to be related both to the location and quality of the stock, as well as the degree of formality of the business:**

- Township Landlords charge the lowest rentals (R97 to R225), which then increases progressively from Subletting Landlords (R898), 1 Unit Landlords (R1038) and 2+ Unit Landlords (R1053), to Business Owners (R1183) and Managing Agent Landlords (R1728) who realise the highest rentals.
- Profits also increase progressively from Sub-letter and 1 Unit Landlords where 32% indicated that they made money, to 2+ Unit Landlords where 62% indicated

they made money and Building Owner Landlords where 75% indicated they made money<sup>30</sup>

In addition, the extent to which **maintenance is undertaken appears to be related to the amount of rental that is realised**. Township and Subletting Landlords undertake the least maintenance (<15% and 19% respectively), followed by 1 Unit and 2+ Unit Landlords (40% and 51% respectively), followed by Building Landlords (75%). In respect of Inner city Landlords the type of maintenance undertaken is generally regular painting, fixing plumbing and damage and addressing structural problems.

**Landlords face a range of different** operational problems, which is often unique to their markets. For example a particularly problem faced by Unit and Managing Agent Landlords is the efficiency of the Body Corporate that manages the building in which they own units. Building Owner Landlords are susceptible to building highjackers. Township Landlords face problems relating to service delivery in their area.

Given the above it is evident that:

- Small Scale Landlords are efficient in undertaking some aspects of managing their businesses for example selecting and managing tenants.
- However support is needed in respect of some categories of Landlords (particularly Township, Subletting and Unit Owner Landlords) especially in respect of assisting and encouraging them to formalise their businesses. This will result in improving the Landlords ability to access finance (see (4) above) and realise profits, and is likely to result in them having the finance to maintain their properties better.
- A negative effect of this is that it could push up rentals, which is problematic given the low levels of affordability of Tenants. In addition for example in Townships the ability to increase rentals is restricted by an informal price ceiling.
- Accordingly any business support provided must occur in a manner that recognises the Landlords strengths and understands and takes cognisance of the market context within which the Landlord is operating.

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<sup>30</sup> Information for Township Landlords and Managing Agent Landlords not available

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- (6) **Type and quality of stock:** The type of stock provided by Small Scale Landlords varies in terms of the category of Landlord but includes a room, a flat or a formal or informal unit. Access to services is generally good in Inner Cities, but is relatively poor in Townships. While the quality of the stock was not surveyed, anecdotal evidence indicates that a large number of Township Landlords (providing both formal and informal units) provide stock that is of a poor quality. This problem is exacerbated by the fact that limited maintenance of the stock is occurring (see (5) above).

Despite the poor quality of stock (especially in Townships) most tenants (over 58%) generally expressed satisfaction with the quality of the unit and the services they receive. However research shows that such stock often has a serious impact on the occupant's health and well being and interventions are required that improve the quality of the stock.

In South Africa the design and construction of housing stock must comply with the relevant requirements of the National Building Regulations and Local Government Town Planning and Building Ordinances and Bylaws. While these specifications vary between Local Governments they are generally significantly higher than what is affordable by Township Landlords. This results in much of the stock being provided by these Landlords not complying.

**There is therefore a need for such requirements to be revised so as to make them more applicable to this market sector. In this regard regulatory requirements should be simple, accessible and understood by all concerned. In addition the challenge is to understand how such dwellings can be effectively upgraded to ensure the health of the occupants, given the resource constraints of both the Landlords and their Tenants. Improving the quality of the rental stock should be linked to the basis on which finance and business support is provided.**

- (7) **Landlord/Tenant relationships:** Small Scale Landlords generally manage their tenants on a personal basis with high levels of informality. Relationships are generally good for most categories and there is a clear understanding by both parties (Landlords and Tenants) of roles and responsibilities:
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- Most Township Landlords, Sub-letters and Unit Landlords do not have written agreements (79-100%) with their tenants. All Building Owner and Managing Agents do.
- Subletting (27%) and Unit Landlords (23-28%) have **less problems collecting rent** than Building Landlords (100%) and Landlords using Managing Agents (30-40%). This could be the result of the **more personal relationship**, which the former have with their Tenants. In Townships, levels of default are low although rescheduling of rentals is relatively common.
- The use of eviction by Landlords **appears to be limited** in respect of both Township and Inner City Landlords. Of those who do use eviction most indicated that they do not experience problems in this regard.
- Generally Landlords (83-100%) believe that the relationship with their tenants is good. This is supported by the Tenants (67-72%) themselves (although to a lesser extent). In addition there is a good understanding of roles and responsibilities by both Landlords and Tenants in respect of all categories.

While there appears to be no specific correlation between having written contracts and good tenant relations, the use of a written contract is good practice. Some of the Successful Landlords (particularly in Township areas) indicated that they were beginning to change to written contracts for this reason (see Resource Report 7). **Accordingly it does appear that written contracts would be beneficial and Landlords should be encouraged to use such contracts.**

- (8) **Regulation:** There is a range of legislation that pertains both generally and specifically to Small Scale Landlords that impacts on the establishment of a legal operating structure, governance of the structure, method of operating and taxation. Legislation and policy that impacts more directly includes the Rental Housing Act (1999), the Urban Renewal Tax Incentive (2005) and the Comprehensive Plan for the Development of Sustainable Human Settlements (Breaking New Ground) (2005). The Urban Renewal Tax Incentive, Urban Development Zones and the Comprehensive Housing Plan (Breaking New Ground) in particular may offer opportunities for Small Scale Landlords
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There is some legislation that has a negative impact on the sector or is not supportive including:

- **Value Added Tax Act, 1991:** which is relevant insofar as the provision of residential accommodation is neither vatable nor is a claim of input Vat. This results in a funding and cash flow cost which impacts negatively on the cost of the provision of rental housing stock.
- **The Income Tax Act:** Which permits exemptions to the construction of new housing stock or stock for households earning less than R1800 per month only. This means that institutions upgrading or converting existing stock cannot access tax exemptions.
- **The legal system and Rental Act:** which are ineffective in providing incentives for tenants to pay for their accommodation
- **The Prevention of Illegal Eviction and Unlawful Occupation of Land Act, 1998 (PIE):** which stipulates that illegal occupiers of a property, who have been residing in the property for more than six, cannot be removed unless alternative accommodation is found for them by the owner of the property.

**Small Scale Landlords have limited understanding of and generally do not comply with regulatory requirements:**

- Most Subletting and Unit Landlords are not compliant in terms of registering their businesses and paying income tax (see (5) above).
- Most Landlords have not heard of recent policy initiatives. Less than 13% of Subletting and Unit Landlords have heard of the UDZ tax incentive and less than 13% have heard of the Rental Housing Act.
- Use of the Rental Tribunal is limited (less than 6% in respect of Subletting and Unit Landlords).
- Over half of Landlords interviewed feel that the Local Government has not been helpful to their business as a Landlord.

**This does suggest that there would be value in providing information to Landlords on the existing regulatory requirements and why they are important, as well as those that offer them opportunities and how they could be applied to improve their businesses.**

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- (9) **Perception and support of the rental sector:** Some Government Officials and Politicians have a negative understanding and often negative perception of the small scale rental sector. Recent Government policy as expressed in the Comprehensive Plan for the Development of Sustainable Human Development calls for the eradication of informal settlements and some Government Politicians and Officials interpret this to include the stock offered by Small Scale Landlords (especially those in Townships).

**There is value therefore in informing Government Officials and Politicians on the important contribution that the sector makes towards housing South Africa's poorer households and how it can be supported to do this in a way whereby the quality of stock provided is improved.**

- (10) **Public Sector Stock:** Public Sector rental housing stock was developed by Government to provide subsidised housing to low income households. Generally no new stock is being developed and existing stock is being disposed through the Sale and Transfer of Housing Stock Policy promulgated as part of the National Housing Act. As at June 2005 it is estimated that a total of 600 000 units have been disposed of and there are approximately 200 000 units still to be disposed. Of this stock it is estimated that a high proportion will be difficult to dispose as a result of it being in a poor physical condition, poorly located, being subject to multiple claims of ownership and/or require a joint management arrangement.

On the basis of the above and a review of two case studies, it is concluded that generally Small Scale Landlords are unlikely to be a key mechanism for addressing hard to sell State Owned Stock without considerable investment by the State. There may be some stock that is appropriate for Small Scale Landlords. The key criteria for this would be:

- Good location
  - The building is in reasonable physical state and/or the relevant Government authority is willing to provide the capital to upgrade the stock into a reasonable state
  - Most of the tenants in the building can afford increased rentals and are willing to remain tenants rather than become owners in a sectional title scheme as envisaged by the EEDBS
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- The relevant Government authority is willing to relocate those tenants who cannot afford increased rentals.

### ***3.2 Home Based Entrepreneurs***

**This section provides an overview of Home Based Entrepreneurs (HBEs) and the context in which they operate** and covers:

- Entrepreneurship in South Africa
- Prevalence of Entrepreneurship
- Contribution of Home Based Entrepreneurs
- Profile of Home Based Entrepreneurs
- Overview of the business
- Types of HBEs
- Formal vs informal
- Motivation and attitudes
- Access to finance
- Support to Home Based Entrepreneurs
- Market sectors
- Use of the house in the business
- Regulation
- The role of Government
- Non Home Based Businesses
- Successful Entrepreneurs
- Conclusions: Home Based Entrepreneurs

This section comprises an analysis of the research undertaken and outlined in Resource Reports 2, 3, 4, 10, 11 and 12.

#### **3.2.1 Entrepreneurship in South Africa**

**Entrepreneurship in South Africa has the potential to drive growth, reduce unemployment and contribute to meaningful BEE. However the growth of the SME sector has been modest. The challenges are considerable. Despite this there are indications that entrepreneurship is becoming an increasingly viable option. The focus of this study is the role of housing in entrepreneurship particularly in respect of SMEs.**

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**Entrepreneurship in South Africa holds the potential to drive growth, reduce unemployment, and contribute to meaningful BEE.** The importance of this role is difficult to overstate in the South African context (see section 1.1). However, in the last ten years the growth of the enterprise sector in South Africa has been **modest and the country lags in terms of international comparisons**<sup>31</sup>. Moreover, government's 'reach' into this sector is seen to be **poor**, although its good intentions are not disputed. South Africa is not unique in this regard. Many countries have found supporting small business to be difficult. The **challenges are considerable**. South Africa has the double challenge of integrating itself into the global markets as a competitive economy, while simultaneously overcoming internal problems created by apartheid.

Despite the above difficulties there are promising signs. According to Trade and Industry Policy Strategies<sup>32</sup> the number of businesses overall in SA increased between 2002-2003, as did the number of employers and self-employed, suggesting that **entrepreneurship is becoming an increasingly viable option**. The number of new private Companies and Close Corporations registered every year has increased almost steadily over the past 12 years.

**On average, micro-enterprises employ approximately one third of South Africa's workers, small businesses account for almost 75% of employment**<sup>33</sup>. The National Small Business Act defines a small business as 'a separate and distinct business entity, including cooperative enterprises and non-governmental organizations, managed by one owner or more which, including its branches or subsidiaries, is predominantly carried on in any sub sector of the economy'. SMEs have increased their role as suppliers of the public sector and of corporate's and their share in national exports and in overall employment has been noted.

The focus of this study is particularly on the **role of housing in entrepreneurship particularly in respect of SMEs**. There are predominantly two ways in which an Entrepreneur can use his/her house – firstly as the **venue for the business and secondly as collateral against which finance can be raised to grow the business**.

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<sup>31</sup> Global Entrepreneurship Monitor

<sup>32</sup> TIPS, The economics of SMME's December 2002

<sup>33</sup> Trade and Industry Policy Strategies *Annual review of small business 2003*

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De Soto in his books *The Other Path* and *The Mystery of Capital* expounds the theory that to escape from poverty poor households need assets that they can put to work. By using their properties such households can apply for loans to start or expand their businesses. A study commissioned by the Finmark Trust et al (2004) estimated that housing in former black townships is worth R68,3 billion<sup>34</sup>. Yet the study found that for a range of reasons, Township Entrepreneurs generally do not leverage capital using their property as collateral. Part of the reasons for this might be related to a reluctance to put their homes at risk, given the up-and-down, extremely dynamic nature of many entrepreneurial endeavours, and downright failure in many circumstances.

Rust<sup>35</sup> however argues that housing is not ‘dead capital’ but does play a role in entrepreneurial development. **Many households use their home as a base for their initial forays into entrepreneurialism.** By using their house as a retail space, a place of production, or for storage within their overall livelihood strategy, households are operating as emerging entrepreneurs.

Sections 3.2.2 to 3.2.13 that follow set out the extent to which Small and Medium Entrepreneurs in Inner Cities and Townships in South Africa are using their home for business purposes and the basis by which this is occurring. Section 3.2.14 sets out findings in respect of Entrepreneurs who do not use their home for business purposes and Section 3.2.15 summarises findings from interviews with 20 Successful Entrepreneurs in respect of whether they used their home in starting and growing their businesses.

### 3.2.2 Prevalence of Entrepreneurship

**Low rates of entrepreneurial activity are occurring in the Inner Cities and Townships surveyed. Of the Entrepreneurs identified most operate from the home (Home Based Entrepreneurs). Many of these HBEs operate below subsistence levels.**

The survey into Entrepreneurs in Inner Cities and Townships commenced with an initial screening to identify Entrepreneurs who could be interviewed (see Resource Report 10). As detailed in Table 15 below, this initial screening revealed **low rates of entrepreneurial**

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<sup>34</sup> Township Residential Property Markets, June 2004, Shisaka

<sup>35</sup> Rust, K *The role of housing in entrepreneurial activity in South Africa* 8 November 2004, p.3

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activity ranging between 13 and 22% within the neighbourhoods surveyed<sup>36</sup>. The highest levels of entrepreneurial activity occurs in Hillbrow/Berea (22%) and the lowest levels in Orlando East with some 13% of units showing entrepreneurial activity. Entrepreneurial activity is slightly lower in Townships (16% on average) than Inner City areas (20% on average). Of the Entrepreneurs identified **most (70%) operate from the home** (Home Based Entrepreneur's), this is higher in Township areas (83 to 89%) than in Inner City areas (39 to 63%).

Table 15: Prevalence and type of Entrepreneurship

		Prevalence*	Extent of HBEs**
<b>Inner City</b>	Tshwane	18	39
	Hillbrow/Berea	22	63
<b>Town-ship</b>	Katlehong	19	89
	Orlando East	13	83
	Mamelodi	17	85
<b>Total</b>		18	70

\* Prevalence: No of entrepreneurs identified as a percentage of total number of units visited.

\*\* Extent of HBE: No of HBEs as a percentage of total number of Entrepreneurs in the area

In order to obtain a sense of the extent to which the Enterprises identified are viable, Table 16 below shows the extent of subsistence of the Enterprises assuming that those earning below R1000 per month are operating on a subsistence basis. As is evident in the Table, just over half of Entrepreneurs that are Home Based are operating on a **subsistence basis**. Only one third of Non Home Based Entrepreneurs operate on a subsistence basis. Generally more Entrepreneurs in Townships operate on a subsistence basis (47-67%) than those in Inner City areas (27-49%).

<sup>36</sup> These rates are comparable to other studies but are low considering the high levels of unemployment and poverty in the country.

Table 16: Extent of Subsistence of Enterprises identified

		% of Entrepreneurs earning below R1000 pm	
		Home Based	Non Home based
<b>Inner City</b>	Tshwane	27	48
	Hillbrow/Berea	49	34
<b>Town-ship</b>	Katlehong	66	50
	Orlando East	67	50
	Mamelodi	50	47
<b>Total</b>		54	31

On the basis of the above it can be concluded that:

- **Low levels of Entrepreneurship are occurring in both Inner Cities and Townships** (16% and 20% on average respectively). This is in accordance with other surveys as detailed in the Literature Reviews (see Resource Reports 3 and 4).
- Of the Entrepreneurs identified **most (over 70%) are Home Based Entrepreneurs** (HBEs), using their home for business purposes. This is more prevalent in Township areas (83-89%) than Inner City areas (39-63%).
- **Many HBEs operate below subsistence levels** with just over half overall (54%) earning below R1000 per month. This is more prevalent in Townships (50-66%) than in Inner Cities (27-49%).

### 3.2.3 Contribution of Home Based Entrepreneurs

**There are approximately 355 000 HBEs active in Townships and Inner Cities in South Africa comprising 13% of the total population of these areas. These HBEs generate an estimated income of R476 million per month.**

While the prevalence of HBEs is limited in Township and Inner City areas(see 3.2 above), the number of HBEs and the cumulative income generated by them is significant. Table 17 below sets out an estimate of the number of and income earned by HBEs in Inner Cities and Townships in South Africa, applying data from the 2001 Census and the 2002 Labour Force Survey and findings from the survey of Home Based Entrepreneurs in Inner Cities and Townships (see Resource Report 10).

Table 17: Estimation of the size and contribution of Home Based Entrepreneurs

Area	No of households <sup>37</sup>	No Home Based Enterprises			Estimated income earned	
		Assumption <sup>38</sup>		No	Assumption <sup>39</sup>	Amt per mn (R million)
		Sector	%			
Townships	2 100 000	Service	3,4	71 400	1302	92,96
		Retail	9,1	191 100	1243	237,5
		Production	1,6	33 600	1096	36,8
		<b>Total</b>		<b>296 100</b>		<b>367,26</b>
Inner Cities	590 000	Service	4,0	23 564	2398	56,5
		Retail	4,3	25 332	1374	34,8
		Production	1,7	10 015	1723	17,3
		Total		58 910		108,6
<b>Overall Total</b>	<b>2 690 000</b>	-	-	<b>355 010</b>	-	<b>475,86</b>

On the basis of the above it is estimated that there are approximately **355 000 households operating an HBE in their home in Townships and Inner Cities in South Africa. This comprising 13% of the total population of these areas. These HBEs generate an estimated income of R476 million per month.**

### 3.2.4 3.2.4 Profile of Home Based Entrepreneurs

**The profiles of HBEs in the Inner City and Townships are different. Entrepreneurs in Inner Cities are predominantly male and are on average almost 10 years younger than those in the Township areas, where more are female. Inner City Home Based Entrepreneurs are also better qualified with significantly more having matric and tertiary qualifications. They also have smaller households and earn higher incomes.**

On the basis of the survey undertaken of HBEs in Inner Cities and Townships (see Resource Report 10) the profile of HBEs in Inner City areas and Townships is as follows:

- **Inner City:** Most of the HBEs are male (57%). Their average age is 36 years. They are well educated with just over half (52%) having matric or above. Approximately 35% are

<sup>37</sup> Census 2001 and Labour Force Survey 2002

<sup>38</sup> Based on an analysis of the data obtained from the Survey of Home Based Entrepreneurs, Resource Report 10

<sup>39</sup> Data obtained from Home Based Entrepreneurs, Resource Report 10

self taught in terms of the skills used in their business. The average size of household is 4 and the mean household monthly income is R3251<sup>40</sup>.

- **Townships:** Just over half of the HBEs are female (54%). Their average age is older than HBEs in the Inner Cities (44 years). They are also less educated with only one third having matric or above (31%). Over half (52%) are self taught in terms of the skills used in their business. The average size of household is slightly larger than in Inner Cities (5 people) and the household income is significantly less (R2053<sup>41</sup>).

A comparative analysis is shown in Table 18 below.

Table 18: Profile of Home Based Entrepreneurs

Characteristic	Measurers	Inner City	Township
Gender	% male	57	46
Age	Mean	36	44
Education	% with matric or above	52	31
Skills source	% self taught	35	52
Household income	Mean (R per month)	3251	2053
No of people per hh	Ave size	4	5

### 3.2.5 Overview of the business

**Most HBEs have stable businesses and most work in the business full time. For many the business is the only source of income. Businesses are generally small and profitability is limited. Most HBEs operate on a personal basis and social networks are important.**

On the basis of the survey undertaken of HBEs in Inner Cities and Townships (see Resource Report 10) key characteristic of the businesses of the HBEs interviewed is shown in Table 19 including:

- Stability
- Size
- Profitability
- Customers
- Competition
- Social capital

<sup>40</sup> This income would include that earned from the Home Based Enterprise, as well as other income

Table 19: Characteristics of the businesses of the Home Based Entrepreneurs interviewed

Characteristic	Measurers	Inner City	Township
Stability	Mean no of years in operation	4	9
	% who work in business full time	77	91
	% where business income is only source of income	57	66
Size	% who have paid employees	19	22
	Av no of full time employees	1	3
	Av no of full time employees who are related to Entrepreneur	0,3	0,5
Profitability	% monthly income less than R1000	33	63
	% monthly income between R1000 to R2499	46	28
	% monthly income above R2499	21	9
	% who made money in the last year	71	56
Customers	% who find customers by passing trade	47	67
	% who find customers by word of mouth	49	52
	% who said it took time to grow a customer base	66	59
	% who provide credit to customers	55	65
	% who charge interest on credit	14	11
Competition	% who have competition	71	82
Social capital	% who receive a lot or some help from family and neighbours to run business	65	73
	% who have contact with other people in the field	54	46

On the basis of the above Table the following is evident:

- **Stability:** The mean period that HBEs have been operating is 4 years in Inner Cities and 9 years in Townships. This implies high levels of stability as the Literature Review indicates that most businesses fail within their first year of operation (see Resource Report 3). Most Home Based Entrepreneurs work in the business full time (77% in Inner Cities and 91% in Townships) and for most the business is the only source of income (57% in Inner Cities and 66% in Townships)
- **Size:** Most businesses appear to be small with less than quarter having paid employees (19% of Inner City businesses and 22% of Township businesses). Where there are employees, the average number is 1 in Inner Cities and 3 in Townships (full time). Some

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<sup>41</sup> Including both income earned from the Home Based Enterprise and income from other sources

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of the employees are related to the Entrepreneurs (30% in Inner Cities and 20% in Townships). The Literature Review (see Resource Report 3) points out that classification thresholds for small businesses in South Africa are low<sup>42</sup>. The National Small Business Act for example defines a business with less than 3 employees as micro and those with below ten employees as very small. It appears therefore that most of the businesses identified in terms of the survey would fall into these categories.

- **Profitability:** Profitability of the HBEs interviewed appears limited, with this being more significant in Townships than Inner Cities. Just over one third earn less than R1000 per month in Inner Cities while just under two thirds (63%) earn less than this amount in Townships. Just under half (46%) earn between R1000 and R2499 in Inner Cities, while only 28% in Townships. Approximately one fifth (21%) are earning above R2500 in Inner Cities and only 9% in Townships. Despite this most HBEs (74% in Inner Cities and 56% in Townships) indicated that they made money in the last year.

A multivariate regression analysis of those HBEs who felt that they made money as opposed to those who felt they had lost money revealed the following:

- Male, young and well educated entrepreneurs are more likely to have made money.
  - HBEs who have paid employees are more likely to have made money than those without paid employees
  - HBEs who took a loan (formal or informal) are more likely to have made money than those who did not.
  - Businesses that are not registered are more likely to have made money than those that are registered.
  - HBEs in the Inner Cities are more likely to have made money than those in the Townships.
- **Customers:** 47% of City Entrepreneurs and 67% of Township Entrepreneurs attract customers from passing trade. This indicates the importance of location of the business. Many HBEs (55% in Inner City and 65% in Townships) provide credit to customers. Most do not charge interest on this credit (86% in Inner City and 89% in Townships).
  - **Competition:** Most HBEs (71% in Inner Cities and 82% in Townships) indicated that they have competition. The limited diversity of the types of business that operate explains the high levels of competition.

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<sup>42</sup> Trade and Industry Policy Strategies

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- **Social Capital:** The majority of HBEs interviewed said that they receive help from family or neighbours. This occurs to a greater extent in Township than Inner City areas (65% in Inner Cities and 73% in townships). Approximately half have contact with other people in their field (54% in Inner City and 46% in Townships).

Social networks appear to have value in that the multivariate regression analysis revealed that HBEs who have regular contact with other Entrepreneurs and people in the same sector are more likely to perceive their business as growing, than those who do not have such contact. HBEs who provide credit are more likely to have made money than those who do not provide credit.

The Literature Review (see Resource Report 3) supports this finding in that Godsell points out, it is easy to overlook the role of trust and personal relationships in business, but the success of the enterprise will depend substantially on relationships and networks of this kind.<sup>43</sup> **Social networks - who people know - have value.** This is particularly the case for SMEs. Whereas physical capital refers to a physical object (house), human capital refers to properties of individuals (education), **social capital refers to the connections among individuals – social networks and the norms of reciprocity and trustworthiness that arise from them.**<sup>44</sup> This trust is good not just for business operations but also plays an important role in terms of poverty alleviation. For example, the bulk of customers of spazas are passing trade or local neighbours. Research by the Finmark Trust in the Financial Diaries Project illustrates that credit lines from spaza shops are one of the most significant financial instruments used by the poor (Finmark Trust 2005).

The interviews with Successful Entrepreneurs (see Resource Report 11) found that the Entrepreneurs interviewed tended to be well networked: 18 out of the 20 belonged to business associations and some even belonged to more than one. Every interviewee pointed to the role played by family and friends- not just in terms of informal loans, but as the source of skills transfer for those skills they use in their businesses.

On the basis of the above the following can be concluded:

- Most Home Based Enterprises are **stable businesses** (operating on average between 4 and 9 years).

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<sup>43</sup> Sunter, C and Godsell, G 'Climate change? Job creation through small and medium enterprises' in *CPS Policy Forum* Job creation series 6, 1999, p.3.

<sup>44</sup> Putnam, D *Bowling alone: The collapse and revival of American community* Touchstone, 2000, p.19

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- Most HBEs work in the **business full time** (between 77-91%) and for many the business is the **only source of income** (57-66%).
- Home Based Businesses are **generally small (micro or very small)** with less than a quarter having paid employees.
- **Profitability of HBEs is limited and many operate below subsistence levels. This is more significant in Townships than Inner Cities:**
  - 63% of Township HBEs earn less than R1000 per month, as opposed to 33% of Inner City HBEs.
  - Only 9% of Township HBEs, as opposed to 21% of Inner City HBEs, earned above R2500 per month.
  - Just under three quarters of Inner City HBEs felt that they made money in the last year as opposed to just over one half of Township HBEs.
- Most HBEs **operate on a personal basis**, attracting most of their customers from passing trade and having a direct relationship with them (for example many HBEs provide credit (55-65%) and most do not charge interest in this regard (86-89%)).
- **Competition among HBEs is high** (71-82% have competitors)
- **Social networks are important** with most HBEs receiving high levels of support from family or neighbours. This is identified as a **key success factor** for the success of the HBE.

### 3.2.6 Market sectors

**HBEs operate predominantly in the retail and services sectors. Different market segments offer different opportunities and challenges. It is important to segment the market and to understand each segment.**

The Literature Review (see Resource Report 4) indicates that HBEs generally operate in the following sectors:

- **Service** : including for example hair salons, mechanics, traditional healers, taxi owners and shebeen operators.
  - **Retail** : Including spaza shops and frozen food retailers
  - **Production** : Including for example fence and gate manufacturers, clothes makers and preparing food.
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On the basis of the survey of HBEs in Inner Cities and Townships (see Resource Report 10) it appears that the predominant sectors within which Inner City HBEs operate is retail (42%) and services (40%), as opposed to Township areas where the predominant sector is retail (65%). Activities in respect of the production sector are extremely limited (18% in Inner Cities and 11% in Townships). The typical business types found in the two areas are shown in Table 20 below.

Table 20: Typical business types

Area	Retail	Service	Production
<b>Inner City</b>	16% Spaza shops and informal fast food businesses 15% Selling (clothes, fruit etc) 5% Shebeens and taverns 2% Street vendors	11% Public phones 5% Hair salons 2,5% range of services including shoe repairs, transportation, car repairs, computer businesses etc	6,5% Dress making 6% Crafts 3% Tailors 2,5% Carpentry
<b>Township</b>	27% shebeen, taverns and beverage sellers 19% spaza shops and fast food sellers 11,5% Selling (sweets, fruit, clothes etc)	5% Crèches 3% Hair Salons 2% Traditional healers 1,5% range of services including satellite installations, scrap collectors, public phone, shoe repairs etc	6% Dressmaking and tailors 3,5% Welding 2% Carpentry

Key findings in respect of the market segments are as follows:

- Of HBEs in the Inner City, 65% in the Service Sector said their enterprise is currently growing, while only half of Entrepreneurs in the Retail and Production sectors said their business is growing. In the Township, HBEs in the Retail sector (64%) said their businesses are currently growing. While only 46% in the Services sector and 36% in the Production Sectors said their business is growing.
- The Retail (21%) and Services (19%) Sectors have the highest number of paid employees in the Inner City, while the Services Sector has by far the highest number of paid employees of all sectors (60%). HBEs in the Retail Sector in Township areas employ on average the most full time employees (7 people), while in the City the Production Sector employs the greatest number of full time employees (2 people).
- HBEs in the Production and Services Sectors in both the City and Townships generally show higher business income than HBEs in the retail sector. Almost half (43%) the

respondents in the retail sector in the City and 68% in Township areas earn less than R1 000 a month.

- The retail sector seems to be most exposed to crime, with almost a third of enterprises (31%) in the Inner City reporting being a victim of crime in the last year, and almost a fifth of Township enterprises (19%) reporting this. This is explained by the fact that the retail operators often store valuable (movable) stock, which exposes them to victimisation.
- HBEs in the production sector across both areas reported that the use of the house was constraining suggesting that some businesses are more suited to HBE activity than those in other sectors (58% in Inner Cities and 42% in Townships).

Given the above the following is evident:

- HBEs operate **predominantly in the retail and services sectors**. Very little activity occurs in respect of the production sector.
- **Different market segments offer different opportunities and challenges.**
- **It is important to segment the market and to understand each segment**, rather than to view HBEs as one homogenous group.

### 3.2.7 Categories of HBEs

HBEs can be categorised into three distinct types namely **Subsistence, Sustainable and Growing**. The **challenges and opportunities are different with respect to each category and therefore different types of support are required**.

As detailed in the Literature Review (see Resource Report 3), small businesses are generally categorised by size. The National Business Act details four categories namely micro, very small, small and medium on the basis of a range of measures including number of full time employees and annual turnover. As detailed in 3.2.5 above on the basis of this categorisation and looking at number of employees only, most of the small business surveyed fell into the micro and very small categories.

For the purposes of this research the HBEs surveyed have been categorised into the following three categories which is based on monthly income earned by the HBE:

- Less than R1000
  - R1000 to R2499
  - R2500+
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Table 21 below outlines a comparison of these income groups in respect of key measures relating to formality of the business, motivation and perceptions of profitability and growth of the business.

Table 21: Comparison of income groups

Charac- teristic	Measurers	Less than R1000	R1000 to R2499	R2500+	Total
Formality	% that have financial statements for the business	2,5	6	27	7
	% not registered as a business	88	78	68	82
	% who made money in the business	56	66	70	61
Motivation	% who would leave the business for a permanent job	38	33	9	32
	% who started the business as they saw a business opportunity	5	14	23	11
	% who started the business in order to survive	37	33	31	35
	% who would like to expand	92	91	93	92
Growth	% who perceive the business to be growing	45	62	76	55
	Main reasons for business growth	More customers (35%), good service (22%), loyal customers (16%)	More customers (28%), good service (17%)	More customers (29%), good service (21%)	
	Main reasons for lack of business growth	Funds (29%), low customer base (25%)	Funds (32%), high competition (18%), low customer base (18%)	Funds (52%)	

On the basis of the above table the HBEs surveyed can be categorised into the following three categories:

- **Subsistence HBEs** : The key characteristics of these HBEs are as follows:

- They earn less than a R1000 per month from the business. If the amount assumed as the Poverty Datum Line (R397<sup>45</sup> per adult per month) is applied (see section 1.1) to the average household size determined in respect of Townships (5) and Inner Cities (4), it can be assumed that households in these areas require a minimum income of between R1389 to R1985 in Townships and R1191 to R1588 in Inner Cities.<sup>46</sup>

These HBEs are earning below this amount and are therefore not able to sufficiently feed their families on the income that they are earning from the business alone.

- The majority operate informally (2,5% have financial statements and 88% are not registered as a business)
  - Very few of these businesses (5%) were started because the HBE saw a business opportunity, rather the business was started in order to survive (37%)<sup>47</sup>
  - Many are not growing but are stagnant. This is evidenced by the fact that just under half did not make money in the business and over half (55%) do not perceive the business to be growing. The main reasons for the business not growing is a low customer base and funds. Over a third of the HBEs in this category (38%) would leave the business for a permanent job.
  - Equally there are some businesses which are growing, 56% of HBEs indicated that they had made money and 45% perceive the business to be growing. The reasons for a business growing is more and loyal customers and good service.
- **Sustainable HBEs:** The key characteristics of these HBEs are as follows:
- They earn between R1000 to R2499 per month from the business. Given a minimum income requirement of between R1389 to R1985 in Townships and R1191 to R1588 in Inner Cities (based on the Poverty Datum Line above), these HBEs are beginning to meet the income requirements of their families, with some excess for those in the higher categories and are therefore sustainable.
  - Slightly more of these businesses are formalised than the Subsistence HBEs although most still operate informally (6% have financial statements and 78% are not registered as a business)

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<sup>45</sup> South Africa Human Development Report 2003. United National Development Programme. The Poverty Datum Line determined for South Africa in 2002 was R354 per month per adult. This has been escalated by an inflation rate of 4% per annum to 2005

<sup>46</sup> This range assumes a household made up at the lower end of 2 adults and children to all adults. 50% of the Poverty Datum Line is assumed for children.

<sup>47</sup> Other reasons included wanting to make money (30%), could not find formal employment (15%), other (13%)

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- Slightly more of these businesses (14%) were started because the HBE saw a business opportunity than the Subsistence HBEs, although just over a third (33%) started the business in order to survive<sup>48</sup>.
  - Significantly more of these businesses appear to be growing than in the case of Subsistence HBEs. Of the sample 66% of HBEs said they made money and 62% perceive the business to be growing. The main reason for growth is that customers and good service.
  - At the same time there are a portion of these businesses that are not growing. Of the sample 38% are not growing and just over one third (33%) of HBEs would leave the business for a permanent job.
- **Growing HBEs:** The key characteristics of these HBEs are as follows:
- They earn above R2500 per month from the business. Given a minimum income requirement of between R1389 to R1985 in Townships and R1191 to R1588 in Inner Cities (based on the Poverty Datum Line above), these HBEs are therefore earning incomes above minimum levels.
  - Significantly more businesses are formalised than the Subsistence and Sustainable HBEs (27% have financial statements and 68% are not registered as a business)
  - Significantly more of these businesses (23%) were started because the HBE saw a business opportunity than the Subsistence HBEs, although just over a third (31%) started the business in order to survive<sup>49</sup>.
  - More of these businesses appear to be growing than in the case of the Subsistence and Sustainable HBEs. Of the sample 70% of HBEs said they made money and 76% perceive the business to be growing. The main reason for growth is customers and good service.
  - Significantly less businesses in this category are not growing. Of the sample less than a quarter (24%) perceive their business to be not growing and only 9% of HBEs would leave the business for a permanent job.

Of significance is that the majority of HBEs regardless of category would like to expand their business (over 91%).

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<sup>48</sup> Other reasons included could not find formal employment (23%), wanted to make money (20%) and other (9%)

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Given the above it can be concluded that the HBEs interviewed can be categorised into three distinct types namely **Subsistence, Sustainable and Growing**. Within each category there is evidence that **some businesses are growing and other are stagnant or stable** and some HBEs are more entrepreneurial than others. It is important to understand the type of business that people are operating in each case. It may, for example, suit some subsistence operators to remain so, because that allows supplemental income to be generated within the home without having to extend to non-family employees and the need for business premises.

Therefore it is evident that the **challenges and opportunities are different with respect to each category and therefore different types of support are required.**

### 3.2.8 Formal vs informal

**The majority of Home Based Businesses are informal. To grow and expand they need to formalise. Backward and forward linkages are critical components of integrating home based businesses into the national economy.**

On the basis of the survey undertaken of HBEs in Inner Cities and Townships (see Resource Report 10) it appears that most Home Based Businesses operate informally. As detailed in Table 22 below the majority of Businesses in both Inner City and Township areas are not registered for VAT (73% in the Inner City and 93% in Townships) or as a business (80% in the Inner City and 83% in Townships). Most do not prepare financial statements (89% in Inner City and 96% in Townships). Furthermore few of the HBEs interviewed belong to business associations – some 18% in Inner City and 12% in Townships. (Entrepreneurs in the services sector in both areas had the highest involvement in Business Associations)

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<sup>49</sup> Other reasons included could not find formal employment (18%), wanted to make money (18%) and other (10%)

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Table 22: Formality of HBEs

Measurers	Inner City	Township
% not registered as a business	80	83
% registered for VAT	13	7
% who prepare financial statements	11	4
% who belong to a Business Association	18	12

**Development of a business requires formality<sup>50</sup>**, because it is only when a small enterprise operates in the formal sector that they can access capital, utilise infrastructure in order to grow or tender for Government contracts(Resource Report 3).

In addition the Literature Review (see Report Report 4) indicates that **linkages between the formal and informal sectors are critical**. Such linkages indicate the extent to which the informal sector is integrated into the national economy. Backward linkages can include:

- A HBE investing his wages, earned through supplying services in the formal sector, into the business
- Marketing networks of dependent or commission sellers (for example S A Breweries supplying beer to a shebeen in the Townships).

Forward linkages are when the output of the informal sector is marketed and sold beyond its own borders (for example a traditional craftsperson selling wares into the formal tourist market).

South African cases studies have found that very few forward linkages exist with the formal sector, but that backward linkages are prevalent, suggesting that HBEs are currently dependent upon the formal sector.

**Given the above it can be concluded that the majority of Home Based Businesses in Townships and Inner Cities are informal. This is more prevalent in Townships than in Inner Cities. If these businesses are to grow and expand they need to formalise. Backward and forward linkages are critical components in respect of integrating Home Based Businesses into the national economy.**

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<sup>50</sup> SBP An enabling environment for private sector growth: Lessons from the international experience November 2002



### 3.2.9 Motivation and attitudes

Not all HBEs show entrepreneurial characteristics. The majority do want to expand and require funds, better business premises and training. The research did not find solid evidence for a 'ladder of development' in which businesses grow along predictable lines.

On the basis of the survey undertaken of HBEs in Inner Cities and Townships (see Resource Report 10) key findings in respect of the motivation and attitudes of the HBEs interviewed are detailed in Table 23 below including:

- Commitment
- Reason for starting
- Entrepreneurship
- Expansion and growth

Table 23: Motivation and attitudes

Characteristic	Measurers	Inner City	Township
Commitment	% willing to leave business for permanent employment	33	32
Reason for starting	% who started business as they saw a business opportunity	17	7
	% who started as they could not find formal employment	15	20
	% who started to survive	29	39
Entrepreneurship	% who were the first person to undertake the business in the area	33	42
Expansion and growth	% who want to expand	95	90
	% who feel business is growing	55	56
	Main reasons for business growth	Customer base growing (27%), loyal customers (16%)	Customer base growing (34%), excellent service (27%)
	For those not growing main reason why	Insufficient money (45%)	Insufficient money (25%), Poor customer base (29%)
	Main things that will help the business grow	Proper place (26%), more money (30%) Training (17)	More money 38%, Proper place (20%) Training (17)

On the basis of the above the following is evident:

- **Entrepreneurship and commitment:** Over one third (33%) of HBEs in Inner Cities and just under half (42%) in Townships **show entrepreneurial characteristics** having been the first person to undertake the business in their area. Only one third (32-33%) of HBEs surveyed in both Inner Cities and Townships said they would **take permanent employment if it was offered to them. This suggests that not all HBEs are entrepreneurial but of those that are there are high levels of commitment and for them entrepreneurship is a viable option.**

The interviews with successful Entrepreneurs (see Resource Report 11) found that success depends on each person - their vision for the business and their comfort levels. In the words of one of the Entrepreneurs interviewed 'not everyone wants their enterprise to be listed on the JSE'.

- **Reason for starting the business:** The most dominant reasons for both Inner City and Township HBEs to start their business relates to survival (Inner Cities 29% and Townships 39%) and an inability to find formal employment (15% in Inner Cities and 20% in Townships). In the Inner City an additional reason is identifying a business opportunity (17%).
- **Expansion:** The majority of HBEs in the Township (90%) and Inner City (95%) want to expand. Many (approximately 55%) feel that their businesses are growing. The main reason for this is that the customer base is growing. Factors that will help them to grow are predominantly more funds, better business premises and training.  
A Multivariate Regression Analysis to determine the variables that impact on whether a HBE perceives his/her business to be growing revealed the following:
  - Males, younger HBEs, with higher levels of education in the retail and services sectors, who have employees are more likely to perceive their businesses as growing.
  - HBEs whose businesses are registered are less likely to perceive their businesses as growing than those who are not registered.
  - HBEs who will take a permanent job if it becomes available are less likely to perceive their business to be growing than those who will not take a permanent job.

The research **did not identify a ‘ladder of development’**. While there was some evidence of categories of business, particularly a high prevalence of subsistence (earning below R1000 pm) there did not seem to be any evidence of businesses progressing predictably from one category to the other. This finding is supported in respect of the interviews with Service Providers and Lenders (see Resource Report 12) where it was indicated that the growth of a business from small to large or graduation from informal to formal does not happen that often and the number of businesses who transcend is low. The reasons for this vary for example Marcell Newsome of The Business Place believes that the growth of a business often depends on how much capitalization the business has. Jo Schwenke from Business Partners on the other hand believes it is related to the talent for entrepreneurship and the willingness to take calculated risks – vision, innovation, passion determination and energy are key factors.

Marcell Newsome says ‘Most businesses that start small generally stay small, medium sized businesses – unless they are able to find significant funding – tend to stay medium, and similarly larger ones tend to stay large. This does not necessarily relate to success or failure, businesses in each of these categories can equally fail or succeed’.

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The interviews with Successful Entrepreneurs (see Resource Report 11) found factors that both support and undermine the concept of a 'ladder of development'. In support of a ladder of development there was clear evidence that many of the Entrepreneurs interviewed had started small and steadily built up their businesses into the successes they currently are. On the negative however many of the Entrepreneurs also suffered set backs and experienced business failure. The dynamic nature of many successful enterprises, the up and down character, downright failure in some cases, means that the metaphor of a ladder is perhaps better understood as 'snakes and ladders'.

On the basis of the above the following can be concluded:

- **Not all HBEs show entrepreneurial characteristics.** Of those that do however there are **high levels of commitment and for them entrepreneurship is a viable option.**
- The majority of HBEs (over 90%) interviewed **want to expand.**
- **Many HBEs feel that their businesses are growing** (over 55%). Factors that will help them to grow are predominantly more funds, better business premises and training.
- The research **did not identify a ladder of development** and it appears that the growth of a business from small to large or from informal to formal does not happen often and is difficult to achieve.
- Factors that impact on the growth of a business include **education levels, formality of the business, access to capital, willingness to take risks and a positive attitude towards growing the business.**

### 3.2.10 Access to finance

**Access to formal finance for most HBEs appears to be limited. There are practical difficulties to lending to start up businesses. Financing support on its own is not enough – business skills and a helpful environment for private sector growth must be developed in tandem.**

On the basis of the survey undertaken of HBEs in Inner Cities and Townships (see Resource Report 10) **access to formal finance for most HBEs appears to be limited.** As detailed in Table 24 below most Entrepreneurs have never had a loan for the business (73% in Inner Cities and 87% in Townships). Most used savings to start the business (64% in Inner Cities and 69% in Townships). For those who did use a loan in most cases it was an informal loan

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(77% in Inner Cities and 77% in Townships). This is despite the fact that levels of blacklisting among Entrepreneurs appears to be low (less than 16%).

Table 24: Access to finance by Home Based Entrepreneurs

Measurers	Inner City	Township
% who have never had a loan for the business	73	87
% who used savings to start business	64	69
% who applied for a loan but were rejected	4	4
% where Bank Manager asked for house as security	1	3
For those who have had a loan % where it was informal	77	77
% who have been blacklisted	16	12

Other than informal loans, there are **two main sources of formal funding for HBEs**, firstly loans provided by Commercial Banks and finance provided by specialist Lenders. In respect of the former such loans are generally in the form of micro loans. (see Resource Report 2). Finance provided by specialist Lenders is detailed in Section 3.2.9 that follows.

The lack of access to formal financial loans and reliance on savings or informal loans is supported in the Literature Review (see Resource Report 3), which indicates that the reality of small business lending is complex, resulting in limited access to loans from formal financial institutions forcing SMEs to resort to savings or informal loans.

**There are practical difficulties in lending to start-up businesses** with no collateral or risk capital, questionable business plans and limited managerial resources<sup>51</sup>. In addition there are important variances between lending to the small, medium and micro categories – different issues relate to different types of businesses, survivalist businesses have different constraints to medium sized businesses.

**Several problems experienced by lending institutions in SA, for example, stem from a lack of capacity to provide aftercare mentoring and selection of appropriate people to support. Small loans to micro and very small enterprises are expensive to administer.** Despite the Saambou and Unifer reminders<sup>52</sup>, it is often forgotten that banks are fragile

<sup>51</sup> Antonie, F 'Financing development: The banking sector and SMMES' in *Indicator* Vol 18, No. 2, June 2001, p.2.

<sup>52</sup> Both of these institutions suffered significant losses due to an inability to recover funds lent in respect of micro loans

institutions. In the words of a South African banker ‘you go a bit loose and soft and you go belly up very quickly in this market.’<sup>53</sup>

The Commission on the Private Sector and Development notes that ‘SMEs are risky ventures. They require risk capital, but the sources of such capital are difficult to tap. So SMEs generally have to turn to classic debt financing. This can be difficult for them, because few entrepreneurs in developing countries can leverage assets as collateral the way they do in developed countries’

The Literature Review (see Resource Report 3) indicates further that while the lack of access to capital is a key constraint to small businesses they face a range of constraints over and above financial needs including access to improved technology, raw materials, skills training and information on market opportunities. **Financing support therefore on its own is not enough – business skills and a helpful environment for private sector growth must be developed in tandem.** Business skills that are targeted, sector specific and delivered in a market based approach are likely to meet with greater success.

Several problems experienced by lending institutions in South Africa, stem from a lack of capacity to provide aftercare mentoring and selection of appropriate people to support.

On the basis of the above the following is concluded:

- HBEs in Inner Cities and Townships have **limited access to formal finance** and rely predominantly on savings and informal loans.
- There are two main sources of formal funding for HBEs firstly **loans provided by Commercial Banks and finance provided by specialist Lenders.**
- There are **practical difficulties** to lending to start up business. **Selection of appropriate people to support and after care mentoring** are key factors.
- Financing support on its own are not enough – **business skills and a helpful environment for private sector growth** must be developed in tandem.

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<sup>53</sup> Interview with Iraj Abedian, Standard Bank, 14 August 2002

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### 3.2.11 Support of Home Based Entrepreneurs

**There are a range of Service Providers providing support service to SMEs, None provide specific support to HBEs and none focus on the role of the house in respect of the SME sector. There is a lack of coordination among Service Providers and many face key challenges. Support programmes to Entrepreneurs have to be focused with a good understanding of the Entrepreneurs motivation and the sector in which s/he operates.**

On the basis of interviews with Service Providers and Lenders (see Resource Report 12), it is evident that there are a number of Service Providers providing focused support to SMEs. No Service Providers that focus specifically on HBEs were identified with the exception of the Tourism Enterprise Programme that provides some support to Bed and Breakfast facilities. The extent of the support varies and is influenced by the agenda of the Service Provider. The support includes both capacity building, access to services and funding. In many cases the support is relationship based and this is seen as a key success factor. An overview of the Service Providers interviewed is set out in Table 25 below.

Table 25: Summary of findings of interviews with Service Providers providing support to SMEs

Organisation	Type of support provided	Processes applied
The Business Place	<ul style="list-style-type: none"> <li>- Business support</li> <li>- Referrals to financial services</li> <li>- Information on financial products and mentoring on the process of accessing financial support (strong focus on relationship with the entrepreneur)</li> </ul>	<p>Focus on Micro to small business providing a one-stop-shop environment including:</p> <ul style="list-style-type: none"> <li>- Three to four different financing companies</li> <li>- 3 consulting companies</li> <li>- 3-4 business training companies</li> </ul> <p>Almost all services are free but a nominal charge is required for some training programmes. Funded by the City of Johannesburg and Investec.</p>
Tourism Enterprise Programme	<ul style="list-style-type: none"> <li>- Acts as a facilitator</li> <li>- Provides support up to 50% of the cost to grow a business in the tourism sector</li> </ul>	<ul style="list-style-type: none"> <li>- Subsidies are provided for the implementation of a business plan brought to them by an Entrepreneur</li> <li>- Work with SMEs</li> <li>- Links the SME to technical support etc.</li> </ul>
ABSA	<ul style="list-style-type: none"> <li>- A range of financial products are provided</li> <li>- Non – financial support is provided including training and mentorship.</li> </ul>	<ul style="list-style-type: none"> <li>- A needs analysis is undertaken to determine what is the most appropriate financial product.</li> <li>- Offer workshops, mentorship and business counselling on a broad basis (not sector specific)</li> <li>- SMEs are required to pay for this support</li> </ul>
Gauteng Enterprise Propeller	<ul style="list-style-type: none"> <li>- Provides financial support in the form of grants and loans</li> <li>- Provides non financial support in the form of training, business mentorship</li> </ul>	<ul style="list-style-type: none"> <li>- SMEs register</li> <li>- An assessment is undertaken and support provided</li> </ul>
Business Partners	<ul style="list-style-type: none"> <li>- Provides finance through a range of products</li> <li>- Mentoring support</li> </ul>	<ul style="list-style-type: none"> <li>- Help the SME raise finance and will share the capital/equity component with the SME</li> <li>- Mentoring is done through business units where mentors meet with the entrepreneur monthly</li> <li>- Also have a pool of consultants who have specific expertise to solve specific problems</li> </ul>



Some of the Service Providers interviewed are exploring new opportunities for expanding their activities as follows:

- **Business Place:** Business Place has developed two new ventures that are more proactive than their current activities. The first is encouraging SMEs based on their interests in a specific sector and the second providing pre-packaged small businesses, for a nominal amount of money (mini – franchises). Business Place is currently looking for resources for these programmes.
- **TEP:** TEP is focusing on developing cultural and business tourism. In this regard TEP focuses on promotion, providing information and developing services in each of these sectors.

Key challenges identified by the Service Providers include:

- Lack of capacity and funding for the Service Providers
  - Lack of co-ordination of activities between Service Providers
  - Quality, monitoring and control of Service Providers providing support to SMEs is a problem, as many are not accredited, are overcharging and provide bad services.
  - The Financial Services Charter could result in Financial Institutions lending recklessly so as to meet their targets.
  - Staff in Financial Institutions often do not have sufficient experience to provide information and support to SMEs. The skills in these institutions is often problematic. In addition who in the Institution should review the application is also problematic and SMEs are often referred from one Department to another.
  - There is an issue around entitlement mentality in SA, where Entrepreneurs do not want to put any of their own finance at risk. For many Financiers unless the Entrepreneur is prepared to provide capital they are not sufficiently committed.
  - Most people are not entrepreneurs and have no desire to be an entrepreneur. If they are forced to become entrepreneurs they are likely to fail. The idea that everyone can run a small business is not true, many people would prefer to be an employee.
  - Business failure of SMEs is high and is often due to the Entrepreneur underestimating the challenges to be faced. Skills of Entrepreneurs is an issue as is passion and vigour. Access to capital is also a key issue.
-

On the basis of the above it can be concluded that:

- There are a **range of Service Providers providing support services to SMEs. None of these Service Providers provide specific support to HBEs and none focus on the role of the house in respect of the SME sector.**
- There is a **lack of coordination among Service Providers** and many face **key challenges** including access to funding and lack of capacity.
- There appears to be increasing recognition among Service Providers that Support Programmes to entrepreneurs have to be **focused** and there needs to be **high levels of understanding** of the entrepreneur's motivation and commitment and the business and market sector (see 3.7 below) in which s/he operates in order to improve chances of success. Accordingly Service Providers seem to be adopting a new approach whereby they are focusing on intensive engagements with fewer SME's rather than providing superficial support to a large number of SME's.
- There is increasing recognition of the need to provide business support and mentorship together with funding support. Accordingly there is a collapsing of the old separation of financial and non-financial support modes.

### 3.2.12 Use of the house in the business

**HBEs generally use a small portion of the house for business purposes. The house has an important impact on reducing the costs of entrepreneurial activity and is therefore a useful incubator in the initial phases of the business. The use of the house as collateral is less widely practiced and is unlikely to be a consideration for businesses that have not reached certain maturity.**

The Literature Review (see Resource Report 3) indicated that there are a number of ways in which housing can play a role in entrepreneurship. The two most frequently mentioned are as the venue for the business and as collateral against which finance can be raised to grow the business.

The survey of HBEs (see Resource Report 10) determined the following key findings (set out in Table 26) in respect of the use of the house in the business. The key findings are outlined in terms of:

- Description
  - Use of the house as security
-

- Use of house for business purposes

Table 26: Use of the house in business

Characteristic	Measurers	Inner City	Township
Description of dwelling	% house	10	100
	% flat	88	0
	% with electricity in dwelling	100	100
	% with water in dwelling	99	72
	% who own	21	62
	% who rent	73	23
	% who acquired dwelling with a loan	39	32
	Amt of rent paid (Mean)	1021	272
	Years in dwelling (Mean)	4	21
Use of house as security	% who know of other entrepreneurs that used house as security	7	6
	For those that used house, % who found it a positive experience	9	29
	% who used house as security for a loan	7	6
Use of house for business purposes	% who use a little space	69	66
	% who use half or more of the space in the house	15	35
	% who feel use the house is helping the business	76	72
	Main ways in which the house helps	Savings on rental (43%)	Savings on rental (42%)
	% who would relocate if they could	71	63
	Main reason for not relocating	Cannot afford to (69%)	Cannot afford (78%)
	% who have received complaints about the business	8	11

On the basis of the above table the following is evident:

- **Description:** Most HBEs in the Inner City (88%) live in flats, while all HBEs in the Townships live (100%) in houses. Access to services is generally good. This can be expected as the survey focused on formal, serviced neighbourhoods. Township entrepreneurs had lived 5 times longer in their current dwelling than City HBEs. Most HBEs (73%) in the Inner City rent their accommodation. More than half of the Township HBEs (62%) own their accommodation, while approximately a quarter rent (23%). The

amount of rentals paid in the Inner City (R1021) is much higher than in the Townships (R272).

- **Use of house as security:** Very few HBEs (approximately 7%) used their house as security for a loan for their business and very few (approximately 7%) know other Entrepreneurs who did. For those who did use their house most did not find it to be a positive experience (91% in Inner Cities and 71% in Townships).

The Literature Review (see Resource Report 3) indicated that the reasons for this is the extremely dynamic nature of many entrepreneurial endeavours. Early mortality of small firms is a global phenomenon. . Colin Anthony notes that about 75% of businesses fail within their first three years<sup>54</sup>.

In a post apartheid context where for many owning a house generates a ‘sense of security, independence and pride’ losing your house might be a devastating consequence of business failure if housing is attached to it.

- **Use of house for business purposes:** Most HBEs (69% in Inner Cities and 66% in Townships) use only a small portion (less than half) of the house for business purposes. Table 27 below sets out the way in which the dwelling is used in the business by sector.

Table 27: Way in which dwelling is used by sector

Sector	Inner Cities				Townships			
	Retail	Production	Service	Tot	Retail	Production	Service	Total
Produce goods	15	48	27	26	20	49	24	24
Bus in house	19	13	12	15	46	4	24	36
Storage/Parking	65	39	52	55	34	47	52	40
Other	1	0	9	4	0	0	0	0

As detailed in the table it is evident that:

- Of the HBEs interviewed many use their house for business-related storage or parking (55% in Inner Cities and 40% in Townships).
- In Inner Cities just over a quarter (26%) of HBEs use the house to produce goods and, as expected this is most predominate in respect of the Production Sector (48%) and to a lesser extent the Service Sector (27%). The location of the business in the house occurs to a lesser extent (15%).

<sup>54</sup> Anthony, C ‘Time for government to get its SME policies right’ in *Real Business* 22 March 2005

- In Townships 36% of HBEs use the house as the location for the business and this occurs predominantly in respect of the retail sector (46%) and to a lesser extent the services sector (24%). Using the house to produce goods occurs to a lesser extent (24%), predominantly in respect of the Production Sector (49%).

Most HBEs (76% in Inner Cities and 72% in Townships) feel that the house is helping the business predominantly in terms of reducing rentals. Most HBEs interviewed indicated that they would relocate if they could. This is more the case in Inner Cities where 71% of HBEs indicated this while 63% of HBEs in Townships. The main reason for not relocating is affordability (69% in Inner Cities and 78% in Townships).

These findings support those of the Literature Review (see Resource Report 3), which indicated that many households use their home as a base for their initial forays into entrepreneurialism. Where the nature of a business is small scale, space costs can be a significant drain on the operation. Using one's home results in an important cost saving. While not identified though this survey the Literature Review (see Resource Report 4) suggests other benefits including a closer relationship with the local customers and employment people within the family.

Given the above is it evident that the house plays a very dynamic role in terms of the entrepreneurial process:

- **HBE generally use a small portion** (less than half) for business purposes. The most common use is for **storage or parking or for producing goods**.
  - Housing has an important impact on **reducing the costs of entrepreneurial activity**, and is therefore a useful business incubator in the initial phases of many businesses.
  - However over time or as the business grows many Home Based Enterprises seem to find the **house uncomfortable and move out if they can**.
  - The **home is not suited to all types of businesses** this is particularly the case in respect of the production sector.
  - **The use of the house as collateral is less widely used and is unlikely to be a consideration for businesses that have not reached certain maturity**. For some very small businesses, finances are already too risky to take on an additional gamble, particularly a large one like a house.
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### 3.2.13 Regulation

**Most HBEs do not comply with business or zoning regulations. High levels of non-compliance imply that the regulatory environment in South Africa is too complex or inappropriate. Reforming the regulatory environment by eliminating artificial and policy induced constraints is a key aspect in facilitating an environment for enterprise growth.**

**Two forms of regulation** are important in respect of Home Based Enterprises firstly **business regulation and secondary zoning regulation.**

**In respect of business regulation** one fifth of the successful entrepreneurs interviewed (see Resource Report 11) mentioned **statutory requirements as a constraint to their business.** As detailed in Section 3.2.6 above most of the HBEs interviewed **do not comply to business regulations.** The finding in respect of successful entrepreneurs and the high levels of informality among the HBEs interviewed can be a sign that the regulatory environment is **too complex or inappropriate** (see Resource Report 3). While it is not possible to make a direct comparison with other countries, the impression is that South Africa **has a high regulatory compliance burden.** A 2004 study suggest that South Africa businesses incurred regulatory compliance costs of about R79 billion, or 6,5% of GDP<sup>55</sup>. While a certain degree of informality is inevitable in Small Scale Enterprises, **widespread non-compliance can devalue the regulatory instruments, be detrimental to the individual businesses and drive a wedge between the informal and formal sectors.**

In overly-regulated sectors many government requirements cannot be enforced which brings the law into disrepute and can encourage corruption.<sup>56</sup> Informal enterprises tend to operate without a 'paper trail' making enforcement of compliance that much more difficult.

**Not all businesses are affected by regulation and compliance costs in the same way.** Sectoral considerations, the size of the firm, its location, how long it has been in operation, and whether the firm is in the formal or informal sector all play a role.

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<sup>55</sup> SBP, Counting the cost of red tape for business in South Africa, Headline report, November 2004

<sup>56</sup> See Hudson, J 'An enabling environment for private sector growth: Lessons from the international experience' SMME Alert published by the SBP, November 2002

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The Literature Review (see Resource Report 3) indicates that generally **small business suffers most** because of their limited administrative resources, uncertain cash flows and limited understanding of their rights<sup>57</sup>. A South African study found that compliance costs represent 8,3% of turnover for enterprises with annual sales of less than R1 million and 0,2% of turnover for corporations with sales of R1 billion or more<sup>58</sup>.

**In respect of zoning regulations**, these regulations have a particular impact on Home Based Enterprises because they regulate the type of and basis by which a business can operate within an area. Regulations governing Home Based Businesses in South Africa, like many other regulations reflect the history of separation that existed in the country for many years. **This framework is partly the reason why this form of entrepreneurship is so limited and has also limited the diversity of activities undertaken (particularly in township areas)**<sup>59</sup> South African home businesses have remained small also because of real regulatory barriers to economic activity in the past, and real and perceived barriers, which still pertain (e.g. unsupportive by-laws and zoning regulations, and licensing limitations). The survey of HBEs (see Resource Report 10) determined that there is **low compliance by HBEs with local by-laws** with 69% of HBEs in Inner Cities indicating that they did not know if their business complies and 40% in Townships. This does not seem to have a negative impact on the businesses (only 22% of Entrepreneurs in Inner Cities and 7% in Townships feel that operating outside of zoning regulations constrains their business). The exception to this was City entrepreneurs in the production sector all of whom reported that not complying with zoning regulations was constraining their business.

The Literature Review (see Resource Report 4) indicates that generally home based businesses receive criticism from three perspectives:

- Some activities are deemed too noxious or nuisance generating in residential areas
- There are concerns about the exploitation of labour
- There are concerns that business activity will overload existing infrastructure.

The above criticisms do not seem to be applicable in South Africa in that very few HBEs interviewed as part of the survey (less than 11%) had received complaints about their businesses.

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<sup>57</sup> J Hudson, An enabling environment for private sector growth: Lessons from international experience, SMME Alert published by the SBP, November 2002

<sup>58</sup> SBP, Counting the cost of red tape for business in SA: Headline report, Nov 2004

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However it is noted that using the home for business purposes is only appropriate for accommodating certain types of business activities and there does seem to be a kind of business that is not that well suited to a home base – for example, in the production sector where the production process is noxious or noisy.

The Literature Review (see Resource Report 3 and 4) indicates that commitment to reforming the regulatory environment by eliminating artificial and policy induced constraints to growth has to be a key aspect in terms of creating a facilitating environment for enterprise growth. The objective of regulatory reform for small business is gaining currency. This is evident in measures announced in South Africa's 2005 budget speech, for example the turnover limit for eligibility for tax relief raised from R5million to R6 million and a change in VAT payment requirements and exemptions in respect of the Skills Development Levy. In addition the concept of Regulatory Impact Assessments, has been adopted by the Presidency and National Treasury. This concept focuses on determining the impact of regulations both existing and proposed on small business. The commitment to the RIA process was reinforced in President Mbeki's State of the Nation address on the 3 Feb 2006 when he said 'We will also speed up the consultative process to determine the measures we must take to improve the regulatory climate to facilitate the expansion of the SME sector. This intervention will form part of the overall programme to introduce a regulatory impact assessment system to enable government regularly to assess the impact of its policies on economic activity in this country.'

The World Bank's *Doing Business*<sup>60</sup> report indicates that the **payoffs for reform appear to be large**. Businesses spend less time and money on dealing with regulations, government spends fewer resources regulating and more providing basic social services. An improved regulatory environment could increase annual economic growth in many developing countries by as much as 1,4% a year.

On the basis of the above the following is concluded:

- Two forms of regulation are important in respect of home based businesses namely **business regulation and zoning regulation**.
- Most of the HBEs interviewed **do not comply with business regulations**. High levels of non-compliance imply that the **regulatory environment in South Africa is too complex**

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<sup>59</sup> Resource Report 4

<sup>60</sup> 2005 study

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**or inappropriate.** The negative effect and cost of high levels of regulation is **more severe in respect of small businesses than larger businesses.**

- Zoning regulations are important because they impact on the type of and basis by which businesses can operate in an area. South African businesses have **remained small and limited both in number and diversity as a result of regulatory barriers to economic activity** including unsupportive by laws and zoning regulations and licensing limitations. This is despite the fact that most HBEs interviewed do not comply and do not see compliance as limiting their businesses.
- **Reforming the regulatory environment by eliminating artificial and policy induced constraints is a key aspect in facilitating an environment for enterprise growth.** This objective is gaining currently and measures in this regard have been announced. In addition the Presidential and National Treasury is exploring the application of **Regulatory Impact Assessments** in this regard.
- The payoffs of reform appear large - business spends less time and money on dealing with regulations and government spend fewer resources regulating.

### 3.2.14 The role of government

**International debates and practice reveal a shift in approaches to the role of Government from that of direct government led provision of support to Government taking on a facilitative or enabling role, whereby Government creates an enabling environment for Enterprises. This must be undertaken in a manner, which balances protecting public interest, but not imposing unnecessary burdens on businesses.**

The Literature Review (see Resource Reports 3 and 4) indicates that international debates and practice reveal a shift in approaches to the role of Government from **direct government-led provision of support to entrepreneurs** to Government taking on **a facilitative or enabling role.**

This affords the private sector a greater role in the delivery of business development services. Thus, there is a shift from supply side interventions to more demand-led strategies. By adopting this approach, government does not ‘crowd out’ private sector business development service but supports them to provide services, while at the same time creating an enabling environment for enterprises.

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Says Bannock, 'Government's explicit focus might usefully shift to removing the barriers that might make the support less necessary and creating an enabling environment.'<sup>61</sup>

This new focus is driven by the recognition that it is typically the private sector, which creates jobs and adds value by combining capital and labour to produce goods and service output.<sup>62</sup>

**Government's role is not minimised but rather focused to be an enabler.**

The key activities undertaken by Government, as an enabler would include for example:

- **Providing appropriate service infrastructure**
- **Reducing unnecessary bureaucracy so to reduce compliance costs for businesses and also lessens the odds against an informal business entering the formal economy by making the process of formalising easier<sup>63</sup>.**
- **Ensuring that existing regulation and any new regulation is relevant and easy to understand**
- **Shifting the focus from punishing wrongdoers to making the system easier to comply with.**
- **Opening public contracts to informal players willing to formalise if they win the contract.**
- **Focusing on self correcting measures based in local societies (e.g. complaints tribunals) rather than restrictive, across the board, regulations.**

Concerns about health and safety, social and environmental costs and benefits are important. In undertaking the above activities therefore, it is important that Governments 'strikes a balance so that regulations protect the public interest but do not impose unnecessary burdens on businesses or stifle growth'.<sup>64</sup> Business should be free to conduct their affairs except where there is a compelling case to protect the public<sup>65</sup> - whether it is from noise disturbance, noxious products, pollution, health and safety hazards and environmental concerns. Policy should ideally take full account of the practical realities for business, particularly small enterprises operating in their specific sectors of the economy.

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<sup>61</sup> Quoted in Hudson, J *An enabling environment for private sector growth: Lessons from the international experience* published by the SBP, November 2002

<sup>62</sup> See Bannock, G et al *Indigenous private sector development and regulation in Africa and Central Europe: A 10 country study* August 2002, p11.

<sup>63</sup> *ibid* p.20

<sup>64</sup> [www.cabinet-office.gov.uk/regulation](http://www.cabinet-office.gov.uk/regulation)

<sup>65</sup> OECD quoted in Hudson, J 'An enabling environment for private sector growth: Lessons from the international experience' SMME Alert published by the SBP, November 2002

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On the basis of the above it can be concluded that:

- International debates and practice reveal a shift in approaches to the role of Government from that of **direct government led provision of support** to **Government taking on a facilitative or enabling role**.
- In this regard Government role is not minimised but becomes that of an **enabler focused on creating an enabling environment** for enterprises where appropriate infrastructure is provided, unnecessary bureaucracy is reduced, regulation is relevant and easy to understand and there is a shift away from punishing wrongdoers to making these system easier to comply with.
- The above however must be undertaken in a manner where a **balance is found between protecting the public interest** in respect of noise disturbance, noxious products, pollution, health and safety hazards and environmental concerns, but not imposing **unnecessary burdens on businesses**.

### 3.2.15 Non Home Based Businesses

**The use of the house is not appropriate for all businesses. The home is a useful incubator for businesses but as businesses formalise and grow they will tend to move out of the house.**

The survey of HBEs (see Resource Report 10) determined the following key findings in respect of those Entrepreneurs interviewed who do not have their business in their home. These Entrepreneurs were not the main focus of the survey, but a statistically valid sample was interviewed in order to understand why such Entrepreneurs were not using their households. The findings indicate that the reason for not using their dwelling was:

- In Inner Cities predominantly that their customers are far from their house (28%), but also insufficient space (18%) and unsuitability of the home (17%)
- In Townships the main reason is that they have a better place (19%), but also insufficient space (17%) and unsuitability of the home (16%).

Most of these Entrepreneurs operate in the Retail and Service Sectors with very few operating in the Production Sector.

Key factors that were significantly different between the Non Home Based Entrepreneurs and the Home Based Entrepreneurs were as follows:

- Non Home Based Entrepreneurs are better educated than Home Based Entrepreneurs with 72% having matric or above in Inner Cities and 46% in Township areas.
- Fewer Non Home Based Entrepreneurs have the business as their only source of income (49% in Inner Cities and 58% in Township areas).
- More Non Home Based Entrepreneurs have registered businesses than Home Based Entrepreneurs.
- More Non Home Based Entrepreneurs have experienced crime in respect of their business in the past year than Home Based Entrepreneurs. This is more significant in respect of Township areas.
- More Non Home Based Entrepreneurs have businesses that comply with zoning regulations than do Home Based Entrepreneurs.

On the basis of the above the following can be concluded:

- The use of the house is **not appropriate for all businesses**, in some cases it is not near the customer based and in others is not suitable or does not have sufficient space.
- The HBEs not using their home are better educated, less reliant on their business in terms of income and appear to be more formalized having registered their business and comply with zoning regulations. This appears to support the finding that the home is a useful incubator for business, but **businesses formalize and grow they will tend to move out of the home or chose not to use the house at all.**

### 3.2.16 Successful Entrepreneurs

**Most Successful Entrepreneurs used their home as an ‘incubator’ for their businesses initially. As the business grew it was moved out of the house. Most used savings to start their business. Only one used their home as security for a loan and this was the Entrepreneur with the largest annual turnover.**

Qualitative in-depth interviews were undertaken with 20 ‘Successful’ Entrepreneurs to complement the primary research undertaken into Home Based Entrepreneurs (see Resource Report 11). The 20 Entrepreneurs interviewed were undertaking a mix of business activities all of which were being operated on a formal basis (mostly as Close Corporations). The Entrepreneurs employed between 1 and 425 employees.

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Most of the Entrepreneurs used the house in terms of the entrepreneurial ventures (18). Uses made of the house included as a venue for the business (Bed and Breakfast) and as an ‘incubator’ for their business in the initial phase, after which the business graduated to more sophisticated levels and moved out of the home. Table 28 below sets out the advantages and disadvantages of using the home for business purposes as identified by the Entrepreneurs interviewed.

Table 28: Advantages and disadvantages of using the home for business purposes

Advantages	Disadvantages
<ul style="list-style-type: none"> <li>▪ Convenience</li> <li>▪ Being close to family</li> <li>▪ Savings on office rental and cost of travelling to work</li> <li>▪ Good security</li> <li>▪ Reduced risk if the business fails</li> </ul>	<ul style="list-style-type: none"> <li>▪ Difficulty in separating work and home life and negative impact on personal space</li> <li>▪ The difficulty in providing a professional image – a concern which grew as the business grew</li> <li>▪ Clients tend to see the individual rather than the business</li> <li>▪ Easy to lose discipline if working from home leading to ‘loafing’</li> <li>▪ Space constraints – difficult to take on more employees</li> <li>▪ Isolation of working at home which constrains access to markets</li> </ul>

While the majority of the Entrepreneurs interviewed used their house in which to locate their businesses initially, only one used the house as security for a loan for the business and was the largest one of the Entrepreneurs interviews with a turnover of some R12 million per annum. Own savings was the dominant form of finance used by the Entrepreneurs interviewed to start their business loan. While calculated risk taking is a key feature of successful Entrepreneurs, part of the reason for not using the house is related to the possible of losing it, being too enormous a risk for many.

All of the Entrepreneurs interviewed had negative perceptions about Financial Institutions. Key issues noted were that Financial Institutions do not understand small business, are inflexible and have complex bureaucracies. There was some fear in terms of committing to loan repayments while the business is still small, especially when cash flow varies from

month to month. In the words of one Entrepreneur interviewed ‘Banks are quick to confiscate your property. I won’t risk losing mine’.

On the basis of the above the following is evident:

- The majority of the Entrepreneurs interviewed **used their house to locate their businesses initially**. As the business grew it was **moved out of the house**.
- Most used savings as the dominant form of finance to start the business. **Only one used their house as security for the loan** and this was the largest with the highest annual turnover. The reason for not using the house was the possibility of losing it should the business fail.

### 3.2.17 Conclusions: Home Based Entrepreneurs

(1) **Importance of the home in Entrepreneurship:** The Entrepreneurial sector in South Africa is seen as a **critical component** in addressing the fundamental issues of **unemployment and poverty**, which the country is currently experiencing, as well as contributing to meaningful **Black Economic Empowerment**. The importance of this role is difficult to overstate with unemployment rates of 26%<sup>66</sup> and 48,5% of the South African population (21,9million people) falling below the National Poverty Line.

However **low rates of entrepreneurship are occurring**. This survey of HBEs in Inner Cities and Townships (see Resource Report 10) found entrepreneurial activity in these areas ranging between 13 and 22% within the neighbourhoods surveyed. These low rates are in accordance with other studies and with the overall growth of the enterprise sector, which has been modest and lags in terms of international comparisons. Government’s interventions into this sector have been poor, although its good intentions are not disputed. This is in accordance with experiences in other countries, which have also found supporting small business to be difficult.

De Soto in his books *The Other Path* and *The Mystery of Capital* expounds the theory that to escape from poverty, poor households need assets that they can put to work. By using their properties such households can apply for loans to start or expand their

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<sup>66</sup> Media briefing by Deputy President Phumzile Mlanbo-Ngcuka, 6 February 2006, Background document, A catalyst for Accelerated and shared Growth-South Africa

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businesses. The survey of HBEs in Inner Cities and Townships (see Resource Report 10) found that small Entrepreneurs in South Africa **are not using their houses as collateral**, as they believe the risk is too high given the rate of failure of small businesses (see (2) below). This supports the findings of a study commissioned by the Finmark Trust et al in 2004<sup>67</sup>.

However as suggested by Rust<sup>68</sup> **a large number of small Entrepreneurs in Inner Cities and Townships are using their home for business purposes i.e. as a venue for the business**. It is estimated that up to **355 000 Home Based Entrepreneurs are active in Townships and Inner Cities comprising 13% of the total population of these areas. These HBEs are generating a significant monthly income of approximately R476 million per month**. While most of these businesses can be classified as micro or small, for many of the Entrepreneurs who own them, they represent their sole income.

It can therefore be concluded that housing in South Africa **is an economically productive asset, offering opportunities for income generation and poverty alleviation**. This is not necessarily in respect of using the house as collateral for a loan as indicated by de Soto, but rather as a venue for a business.

The fact that so few people are using their houses (either as collateral to raise finance or as venue for business) means that there is **untapped opportunity. There is therefore value in supporting existing HBE, so that they can operate more effectively and expand, as well as promoting the use of the house to assist the emergence of new Entrepreneurs**. In order for this to occur there is a need to change the way in which HBEs are governed and supported.

- (2) **Use of the home:** As detailed in (1) above very few of the HBEs interviewed (6-7%) **used their house as security for a loan for their business**. The Literature Review (see Resource Report 3) indicated that the reason for this is the extremely dynamic nature of many entrepreneurial endeavours. Early mortality of small firms is a global

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<sup>67</sup> Township Residential Property Markets, June 2004, Shisaka

<sup>68</sup> Rust, K The role of housing in entrepreneurial activity in South Africa, 8 November 2004

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phenomenon. Colin Anthony notes that about 75% of businesses fail within their first three years<sup>69</sup>.

Rather HBEs use the house as a **venue for their business**. In this regard such HBEs are providing a **range of services** predominantly in the retail and services sectors and to a lesser extent in the production sector. The survey of HBEs in Inner Cities and Townships (see Resource Report 10) found that the type of business differs between Inner Cities and Townships and includes a range of diverse activities as detailed in Table 29 below.

Table 29: Typical business types

Area	Retail	Service	Production
<b>Inner City</b>	16% Spaza shops and informal fast food businesses 15% Selling (clothes, fruit etc) 5% Shebeens and taverns 2% Street vendors	11% Public phones 5% Hair salons 2,5% range of services including shoe repairs, transportation, car repairs, computer businesses etc	6,5% Dress making 6% Crafts 3% Tailors 2,5% Carpentry
<b>Township</b>	27% shebeen, taverns and beverage sellers 19% spaza shops and fast food sellers 11,5% Selling (sweets, fruit, clothes etc)	5% Crèches 3% Hair Salons 2% Traditional healers 1,5% range of services including satellite installations, scrap collectors, public phone, shoe repairs etc	6% Dressmaking and tailors 3,5% Welding 2% Carpentry

These services are offered on the basis that they:

- **Provide credit (55-65%)**
- Rely on a **local customer base (47-67% find customers by passing trade)**
- Provide goods and services on a **personalised basis and with high levels of convenience (only 11-14% charge interest on credit)**
- Structure their services to the **needs of the customer base** for example in Townships retail outlets offer smaller quantities that cannot be purchased in more formal retail outlets.

<sup>69</sup> Anthony, C 'Time for government to get its SME policies right' in *Real Business* 22 March 2005



In providing this service, most HBEs (66-69%) use only a small portion of their house (less than half). Uses vary by area and sector but include:

- **Storage and parking** which is the highest usage in both areas and in almost all sectors
- A **place to produce goods**, obviously in respect of the production sector in both Inner Cities and Townships
- A **location for the business**, which occurs predominantly in Townships in respect of the Retail Sector and to a lesser extent the Service Sector.

The use of the house has both **advantages and disadvantages**. The interviews with Successful Entrepreneurs identified the advantages as being convenience, close to family, savings on office rental and costs of travelling to work, good security and reduced risk if the business fails. The disadvantages included difficulties in separating work and home life, difficulty in providing a professional image, space constraints and isolation.

It was evident both in respect of the interviews with HBEs and Successful Entrepreneurs, that the house plays an important role particularly in the **incubation phase** of a business or if a **business is not growing**. However as a business grows and expands, unless the house is the location for the business and the customer base is located in the area, many Entrepreneurs will move the business out of the house if they can afford to do so. Of the HBEs interviewed for example most said that they would relocate if they could. This is more the case in Inner Cities where 71% indicated this, while 63% of HBEs felt this in Townships. The main reason for not relocating was cited as being affordability (69% in Inner Cities and 78% in Townships).

There does not appear to be **any objection by residents** in the area in which the businesses are located, to the activities that are undertaken. Of all HBEs interviewed only between 8 to 11% indicated that they had received complaints about the business. **Access to services appears good** in Inner Cities and **adequate** in Townships.

On the basis of the above it is evident that the activities being undertaken by HBEs in Inner Cities and Townships are **well accommodated in the house in residential areas**.

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Some will grow beyond and out of the house and into business premises and some will remain.

- (3) **Township vs. Inner cities:** The survey of HBEs in Inner Cities and Townships (see Resource Report 10) found that the profile of HBEs that operate in Townships and Inner Cities are **different**. HBEs in Inner Cities are predominantly male (57%), whereas in Townships they are more likely to be female (54%). On average HBEs in Inner Cities are almost ten years younger than those in Township areas (36 years as opposed to 44 years).

HBEs in Inner Cities are also better qualified than those in Townships (52% have matric and above as opposed to 31% in Townships) and more have training than those in Townships (35% of HBEs in Inner Cities are self taught as opposed to 52% in Townships).

HBEs in Townships **are less profitable** than those in Inner cities. Township HBEs appear to be more survivalist businesses, in which people supplement the little they have in providing services to their neighbours. This is evident from the following:

- 39% of Township HBEs indicated that they started their business because they needed to survive, whereas only 29% of Inner City HBEs cited this reason
- Only 56% of Township HBEs said they made money from their business in the last year, whereas 71% of Inner City HBEs had made money.
- Entrepreneurial activity is lower in Townships (ranging between 13 –19%) and higher in Inner Cities (18-22%)
- More HBEs operate below subsistence levels in Township (50-66%) than in Inner cities (27-49%)
- Household monthly income of HBEs in Townships is significantly less than those of Inner Cities (R2053 as opposed to R3251)

The reason for this is that the **physical, social, economic and legislative context** of Townships militates against the emergence of more viable home businesses. The **customer based in Townships is limited** with low incomes. There is better access to markets and higher thresholds of customers in Inner Cities because of the greater population density and because it is a mixed use settlement.

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Given the above it is evident that **different types of initiatives and programmes** are required in respect of supporting existing Township and Inner City HBEs and encouraging the emergence of new HBEs.

- (4) **Types of HBEs:** An analysis of the data obtained through the survey of HBEs in Inner Cities and Townships (see Resource Report 10) indicates that HBEs can be categorised into three distinct types namely **Subsistence, Sustainable and Growing**. Table 30 below provides an overview of the key characteristics of these categories.

Table 30: HBE categories

Category	Key characteristics
Subsistence	<ul style="list-style-type: none"> <li>- Earn less than R1000 pm from the business</li> <li>- Business was started in order to survive (37%)</li> <li>- Operate informally (2,5% have financial statement and 88% not registered as a business)</li> <li>- Many are not growing but are stagnant (55% do not perceive the business to be growing, 38% would leave the business for a permanent job)</li> <li>- Some are growing (56% have made money in the last year and 45% perceive the business to be growing)</li> </ul>
Sustainable	<ul style="list-style-type: none"> <li>- Earn between R1000 and R2499 pm from the business</li> <li>- Business was started by some because they saw a business opportunity (14%) but by one third in order to survive (33%)</li> <li>- Operate informally (6% have financial statement and 78% not registered as a business)</li> <li>- Many are growing (66% have made money in the last year and 62% perceive the business to be growing)</li> <li>- Some are not growing but are stagnant (38% do not perceive the business to be growing, 33% would leave the business for a permanent job)</li> </ul>
Growing	<ul style="list-style-type: none"> <li>- Earn above R2499 pm from the business</li> <li>- Business was started by many because they saw a business opportunity (23%) but by one third in order to survive (31%)</li> <li>- Some operate formally (27% have financial statement and 68% not registered as a business)</li> <li>- Many are growing (20% have made money in the last year and 76% perceive the business to be growing)</li> <li>- Some are not growing but are stagnant (24% do not perceive the business to be growing, 9% would leave the business for a permanent job)</li> </ul>

Within each category there is evidence that **some businesses are growing and other are stagnant**. Furthermore it is evident that the **challenges and opportunities are different** with respect to each category and therefore **different types of support are required**.

The prevalence of these different categories of HBEs is as follows:

- In Inner Cities most HBEs are Sustainable (46%) or Growing (21%). One third of HBEs are Subsistence.
- In Townships most HBEs are Subsistence (63%). Just under one third (28%) are Sustainable and very few (9%) are growing.

The research **did not identify a ‘ladder of development’**. While categories of business were identified as detailed above, there did not seem to be any evidence of businesses moving from one category to the other. This finding is supported in respect of the interviews with Service Providers and Lenders (see Resource Report 12) where it was indicated that the growth of a business from small to large or graduation from informal to formal does not happen that often and the number of businesses who transcend is low. The reasons for this vary and include for example the amount of capital an HBE can access, the talent for entrepreneurship that the HBE has and his/her innovation, passion determination, energy and willingness to take risks.

Some Successful Entrepreneurs had started small and steadily built up their businesses, others however had suffered set backs and experienced business failure. The metaphor of a ladder is perhaps better understood as ‘snakes and ladders’.

(5) **Entrepreneurship:** The survey of HBEs in Inner Cities and Townships (see Resource Report 10) found that **not all HBEs show entrepreneurial characteristics**. This is evident by the following:

- Approximately one third (32-33%) of HBEs surveyed said they would take permanent employment if it was offered to them.
- Over one third (29-39%) of HBEs surveyed said they started their business in order to survive and 15 to 20% due to an inability to find formal employment.

However there are **a significant number of HBEs who are entrepreneurial**. This is evident by the following:

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- Between 33 and 42% were the first person to undertake the business in their area.
- Between 7 and 17% started their business because they saw a business opportunity

The interviews with successful Entrepreneurs found that **success depends on each person** – their vision for the business and their comfort levels. A Multivariate Regression analysis of the HBEs interviewed determined that factors that impact on the growth of a business include education levels, formality of the business, access to capital, willingness to take risks and a positive attitude towards growing the business.

The above suggests that **when providing support to HBEs care should be taken in the selection of the HBE**, so that the support is provided to those individuals who are entrepreneurial. The main drivers for a successful business is the Entrepreneur who owns it and is willing to take risks, fill niches and grab opportunities.

(6) **Access to finance:** The survey of HBEs in Inner Cities and Townships (see Resource Report 10) found that **access to formal finance for most HBEs appears to be limited** and most used **savings or an informal loan to finance their business:**

- 73% of HBEs in Inner Cities and 87% in Townships have never had a loan for their business.
- 64% of HBEs in Inner Cities and 69% in Townships used savings to start their business.
- For those who did use a loan for 77% of HBEs in both Townships and Inner Cities the loan was informal.

There are two main sources of formal funding for HBEs, namely loans provided by Commercial Banks and finance provided by Specialist Lenders. The lack of access to these loans is the result of the **complexity of lending to small start up businesses**, which are often informal, have no collateral or risk capital, questionable business plans and limited managerial resources.

As detailed in (4) above there are **important variances in respect of the different types** of HBEs that **influences the different types of financial products** they could access.

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**Access to finance that is appropriate for HBEs need to be significantly increased.**

The high risk of small business as detailed in (2) has resulted in a reluctance by HBEs to use their house as collateral for a loan for their businesses. This implies that **Lenders should develop alternative lending products that do not rely on the home as collateral. The raising of awareness around access to finance, and knowledge of the types of conditions that come with such schemes,** is an area that needs to be actively supported.

The Literature Review indicates further that while the lack of access to capital is a key constraint to a small business, they face a range of constraints over and above financial needs including access to improved technology, raw materials, skills training and information on market opportunities.

**Financing support on its own is not enough – business skills and a helpful environment for private sector growth must be developed in tandem.** Business skills that are targeted, sector specific and delivered in a market based approach are a critical success factor. Financial Institutions often do not have sufficient experience, capacity or structures to provide support to Entrepreneurs in terms of these additional requirements. Several problems experienced by lending institutions in South Africa, stem from a lack of capacity to provide business support, as well as the selection of appropriate people who are entrepreneurial (see (5) above).

- (7) **Business support:** There are a number of Service Providers providing focused support to SMEs (see Resource Report 12). **None of these provide specific support to HBEs and none focus on the role of the house in respect of the SME sector.** The extent of the support varies and is influenced by the agenda of the Service Provider. The support includes both capacity building, access to services and funding. In many cases the support is relationship based, and this is seen as a key success factor.

Key challenges exist including lack of capacity and funding for Service Providers, lack of coordination among Service Providers and poor quality and monitoring of the quality of services provided.

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Support programmes to Entrepreneurs have to be **focused** and there needs to be **high levels of understanding of the Entrepreneurs motivation and commitment** and the **business and market sector in which s/he operates** in order to improve the chances of success.

- (8) **Formal vs. informal:** The survey of HBEs in Inner Cities and Townships (see Resource Report 10) found that the **majority of the HBEs interviewed operate informally**. However levels of formality are higher in Inner Cities and for Sustainable and Growing HBEs as opposed to Subsistence HBEs (see (4) above). In general
- 80-83% of HBEs are not registered as a business
  - 7-13% are registered for VAT
  - 4-11% prepare financial statements

**Development of a business requires formality** because it is only when a small enterprise operates in the formal sector that they can access capital and utilise infrastructure in order to grow.

**Linkages between the formal and informal sectors are critical.** Such linkages indicate the extent to which the informal sector is integrated into the national economy.

Two types of linkages occur:

- Backward linkages include a HBE investing his wages from the formal sector into his business or marketing networks of dependent or commission sellers (for example SA Breweries supplying beer to a sheen)
- Forward linkages comprise the output of the formal sector being marketed and sold beyond its own borders.

**No evidence of either backward or forward linkages were identified through the research.** Other South African research (see Resource Report 4) have found that very few forward linkages exist with the formal sector, but that some backward linkages occur.

**Given the above it is evident that support must be provided to HBEs to assist them in formalising their businesses. Developing backward and forward linkages are important in this regard.** The backward linkages of HBEs from the formal sector

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should be developed and strengthened. Similarly, forward linkages which are almost non-existent need to be developed.

(9) **Regulation:** The survey of HBEs in Inner Cities and Townships (see Resource Report 10) found that most HBEs do not comply with business or zoning regulations:

- In respect of **business regulations** one fifth of the Successful Entrepreneurs interviewed mentioned statutory requirements as a constraint to their business. Most of the HBEs interviewed (see (8)) above do not comply with business regulations. High levels of informality can be a sign that the regulatory environment is too complex or inappropriate. This would support indications that **South Africa has a high regulatory compliance burden**. This affects **small business to a greater extent than larger business** because of their limited administrative resources, uncertain cash flows and limited understanding of rights and responsibilities.
- In respect of **zoning regulations**, these regulations have a particular impact on HBEs because they regulate the type and basis by which a business can operate within an area. Regulations governing HBEs in South Africa reflect the history of separation that existed in the country during apartheid and **create barriers through unsupportive by-laws and zoning regulations and licensing limitation**. The survey of HBEs in Inner Cities and Townships (see Resource Report 10) found low levels of compliance with these regulations (40-69% of HBEs did not know if their businesses complied with zoning regulations)

It is evident therefore that there is a **need for regulations pertaining to business and zoning to be reviewed**. The objective of regulatory reform for small business is gaining currency. This needs to be extended to incorporate HBEs. **Regulatory Impact Assessments** are seen as a basis for understanding the impact that regulations have and to ensure that any revisions made are effective and appropriate. Reforming the regulatory environment should focus on **eliminating artificial and policy induced constraints and creating an environment that will facilitate enterprise growth**.

(10) **Role of Government:** The role of Government is to create a **positive environment** within which HBEs can form and grow. This refers both to existing HBEs, as well as creating opportunities for new HBEs to emerge. Government role should focus on:

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- Providing **access to services, infrastructure and property rights**
- Ensuring that **new areas that are developed accommodate and support** entrepreneurial development
- **Amending the regulatory environment** in respect of planning, environmental and business regulations so that they support legitimate business activities and assist and encourage individuals who wish to start businesses
- **Provide support to and monitoring the services** of Service Providers who are assisting Entrepreneurs so that they have increased capacity and provide high quality services.

Local and Provincial Government has a **particular role to play**. In this regard they should not be directly providing support to individual businesses, but rather focusing on creating enabling environments within their areas of jurisdiction. The kinds of activities that should be undertaken could include:

- Providing information which promotes residential based enterprises
  - Provide information about service providers which are able to assist entrepreneurs with skills finance etc
  - Train their officials and politicians in the importance of supporting enterprise and striking the balance between regulating harmful practices and unnecessarily obstructing harmless activities. In this regard there needs to be coordination and a shared devotion to promote enterprises within Local Government both by the Economic Development Dept and the Building and Regulation and Environment Departments, who need to work together to promote small business both within and outside of the home.
  - Ensuring that commercial sites for small enterprises are available both within existing residential areas and in planned residential areas.
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## 4 Overall conclusions

This report sets out research into **Housing Entrepreneurs including Small Scale Landlords and Home Based Entrepreneurs**, both of which use the home as a basis for generating income. It is estimated that currently these Housing Entrepreneurs are **generating significant income** as a result of their activities estimated to be **R900 million** per month. Many of these Housing Entrepreneurs fall within the low income categories.

The research found further that **significant opportunities exist**, both in terms of existing Housing Entrepreneurs growing their businesses, as well as encouraging the emergence of new Housing Entrepreneurs.

Given the challenges faced by South Africa of high levels of unemployment and poverty, Government needs to recognise that **housing is an economically productive asset** that can be used to create income. This can occur in a manner that is **not detrimental to the environment or residential areas**. Government policy needs to shift to recognise this and initiatives and programmes should be implemented by both Government and the private sector to support the growth and development of Housing Entrepreneurs.

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## **Annexure A: Schedule of case studies reviewed**

**The Bangladesh Rural Advancement Committee** which provides credit and business development services within a few productive market sectors.

**Shore Bank Corporation** which provides finance to entrepreneurs to rehabilitate apartment buildings.

**Global Financial Innovations Partnership** which is a mode for leveraging capital and technical assistance resources to 'slum dwellers'.

**Domenia Credit (Romania)** which was one of the first specialised mortgage institutions established in Romania after the collapse of socialist rule in the country.

**Alpha Bank (Greece)** which provides mortgage finance in Romania

**Romanian – American Enterprise Fund** which provides assistance to young Romanian entrepreneurs so as to create small to medium enterprises.

**Community Investment Corporation** which provides loans to encourage affordable housing and neighbourhood revitalization in Chicago, USA.

**City Bank of D.C** which offers banking services specifically for lower to middle income earners in Washington D.C, USA.

**State of Maryland Community Development Agency (USA)** which provides both wholesale and retail finance to achieve equal housing opportunities.

**Manna Mortgage Corporation (USA)** which sources funds from the federal government and donor agencies to address housing shortages for low to middle income earners.

**Shorebank Corporation**<sup>70</sup>: Provides loan funding and support to assist small scale landlords in purchasing, rehabilitating and managing buildings for rental in downgraded areas.

**Small landlords in Australia**<sup>71</sup>: Small landlords in Australia have prospered due to a taxation regime which encourages this form of ownership. All expenses associated with the rental property, including mortgage financing costs, can be deducted against the landlords total income for income taxation purposes providing individual investors with a flexible, controllable, and accessible avenue of investment.

**National Landlords Association**<sup>72</sup>: The National Landlords Association (NLA) is an association of Landlords to protect and promote the interests of residential landlords operating in the private rented sector in the United Kingdom. The NLA lobbies central government and

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<sup>70</sup> This section adapted from L Pikholtz 2001 and the Shorebank Corporation website

<sup>71</sup> M Berry, 2000

<sup>72</sup> National Landlords Association website

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local authorities and provides a range of benefits and services to individual members including a telephone advice line, journals and more.

**Transformations in Israel**<sup>73</sup>: This comprises a multi-sectoral programme focusing on low quality neighbourhoods, whereby loans were provided to owners and landlords of properties living in medium rise flat accommodation to upgrade and expand their units. A local facilitator (Project Renewal local officer) is used to assist and encourage participants into the programme

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<sup>73</sup> This section adapted from Graham Tipple, *Extending Themselves*, undated

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## Annexure B: Legislation pertaining to private sector rental stock in South Africa

<i>Regarding legal entities</i>	
Companies Act (section 21 companies and private companies) no. 61 of 1973 and relevant amendments	For the registration of the legal entity. Set criteria to which the legal entity must adhere and report on (see governance)
<i>Regarding governance</i>	
King 2 report on corporate governance	Sets out corporate governance requirements for public and private companies.
Promotion of access to information Act 2 of 2000	Disclosure of information on request to ensure transparency and accountability
<i>Regarding operations</i>	
Constitution, Act 108 of 1996	Right to access housing Eviction only possible through an order of court i.e. security of tenure
Housing Development Act 107 of 1997	Principles for the development of housing Framework for operating in subsidy market Defining roles of the key players in the sector
Rental Act 50 of 1999	Details government responsibility in the rental housing sector Lease agreement requirements Landlord tenant relationships through the establishment of tribunals Treatment of deposits and limitations on rent increases
National Housing Code	Details of using the various subsidy instruments available under the capital subsidy programme
Provincial housing legislation and policies	Captures provincial enhancements to the housing subsidy scheme and policy to be adaptive to the context in the province
Local authority policies and bylaws	Captures local area specific requirements that residential property owners have to adhere to and maintain. Linked to the town planning and zoning
PIE – Prevention of Illegal Eviction and Unlawful Occupation of Land Act, 1998	Significantly affects the ability to evict defaulting residents, as the process is long and costly.
Basic conditions of employment, Labour relations and employment equity legislation	This legislation affects the recruitment, selection, development, performance review and administration of staff
Financial Charter	Proposed to bring private financial institutions into the low income housing sector. Small scale Landlords could benefit from funding from these organisations to diversify their funding sources and spread risk
<i>Regarding development and land</i>	
Development Facilitation Act 67 of 1995	Comes in to play when accessing land for the development of rental housing. The principles in Chapter 1 are applicable in all provinces.
Town planning legislation – provincial	Comes in to play when accessing land for the development of

ordinances	rental housing and zoning land for rental housing development
Municipal housing plans and integrated development plans and provincial development plans	Defines nodal areas targeted for development, details public funding available for the areas identified. Assists in planning the location of housing developments
NHBRC/Consumer Protection Measures Act 95 of 1998	This applies during the development stage of a project and will affect the Landlord if they act as developers of the project. The additional levy added for NHBRC cover adds to the cost of construction of the product and in the case of rental units adds a third level of insurance to the development, whereas in the case of instalment sale does not necessary benefit the prospective homeowner as transfer occurs after year 4
<i>Tenure</i>	
Sectional titles Act 95 of 1986	Applies to sectional title developments
<i>Regarding taxation</i>	
VAT Act	Zero-rating of subsidies for VAT not applicable to rental housing development.
Income tax legislation	Income tax exemption for units under R!800
Property Rates Act	Regulating the property rates regime

Source: Social Housing Policy for South Africa: Towards an enabling environment for social housing development: Draft 2005

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