What is the gap market?

The Income and Expenditure Survey (2005/06)¹ provides the following household income distribution for our population. While households earning less than R3500 qualify for the government housing subsidy (64% of the population – the blue and red bars), the cheapest newly built house (at about R230 000) is affordable at current finance rates for this market, to households earning about R9000.

This means that households earning between R3500 and R9000, key public sector workers and labourers, are too rich to qualify for a housing subsidy, but too poor to afford a newly built house available on the market. This is the gap market.

¹ The Income and Expenditure survey of 2005/06 is the most comprehensive, and arguably, the most accurate income and expenditure data we have. It includes data on salaries, wages, as well as grant income. According to the 2007 Community Survey, 31% of households (3.8 million) have a monthly income of between R1600 – R6400. A further 8% (about 952 000) have an income of between R6 400 and R12 800. This survey is based on personal income of household members, captured in fairly wide bands. It is therefore indicative at best. (Commentary from Eighty20)
The gap extends above the R230 000 house, however, as there is insufficient delivery to meet the potential demand. The delivery of houses smaller than 80m² has never gone above 25 000 units per annum – although up by 11.1% in this past six months between January and June 2009, the total delivery rate for the six month period was only 11 493 units smaller than 80m². Yet, the Banking Association estimated in 2005 that there was a backlog of housing affordable to the then FSC target market of about 625 000 units. At that time, it was estimated that an annual delivery of about 132 000 units was required to address the backlog and accommodate population growth.

<table>
<thead>
<tr>
<th>Category of housing</th>
<th>Plans passed</th>
<th>Buildings completed</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Number</td>
<td>Number</td>
</tr>
<tr>
<td>Houses of &lt;80m²</td>
<td>12 728</td>
<td>11 737</td>
</tr>
<tr>
<td>Houses of ≥80m²</td>
<td>11 762</td>
<td>7 016</td>
</tr>
<tr>
<td>Flats &amp; townhouses</td>
<td>15 822</td>
<td>7 256</td>
</tr>
<tr>
<td>Total</td>
<td>40 312</td>
<td>26 009</td>
</tr>
</tbody>
</table>

Source: Stats SA

Arguably, the gap market could extend across all households earning between R3500 and R18 000 (affording a house of about R440 000) – that is, about 27% of the population or about 3,5 million households. Some developers extend their definition of the gap market even further, to houses costing as much as R750 000, affordable to households earning about R26 000 per month.

Not all of these households would want to participate in the housing market and purchase new housing. However, the Income and Expenditure Survey shows us that 15% of those earning R3500 – R8000 and about 4% of those earning R8000 – R12 000 live in informal housing, their income notwithstanding. Others live in overcrowded conditions, or inadequate structures, and some rent. **All of this points to a problem with supply: there are not enough affordable houses to meet the demand in this market.** As illustrated in the table below, only about 25% of households earning R3500 – R8000 are adequately housed in ownership accommodation, and less than half in the category of households earning R8000-R12000 are adequately housed. While the rental proportion in each category is significant, housing quality factors are not insubstantial in these income groups.

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2 Calculated at prime plus 2% (13%) over 20 years at 30% installment to income; 100% loan to value.
3 Calculated at prime (11%) over 20 years at 30% installment to income; 100% loan to value.
The number of households in the middle-income markets living in inadequate and informal conditions (just over 620 000 households in the R3500 – R8000 income range) is a very real problem (and opportunity) that is begging to be addressed.

A further category of supply relates to rental housing. While this is not explicitly tracked, it is possible that some of the new construction highlighted by Stats SA will be offered on a rental basis to those with affordability. This may mean that some of the delivery in the flats and townhouses category (25 981 new flats and townhouse units were delivered in 2008) may have been for rental purposes, and possibly in the affordable market. However, research undertaken for the SHF in 2008 found a “significant shortage of rental accommodation, if not countrywide, then certainly in large urban areas.” While an estimated 20% of the South African population (about 2.4 million households) rents their main accommodation, over 25% of these are shacks and backyard dwellings. According to the SHF, state-subsidised rental housing as offered by the 56 social housing institutions in South Africa, accounts for only 53 000 units. Private institutional landlords operating in some of South Africa’s larger inner cities provide unsubsidised, rental accommodation to the low-moderate income market; however, the scale at which they operate is insignificant to meet the demand. The SHF report found that the bulk of residential rental stock in South Africa is provided by smaller private investors, including households.

Of course, all the above begs the question why is it not possible to build more housing units more quickly? Research undertaken in 2005 by the Banking Association into housing supply and functioning markets explored this question in detail and found that the main problem had to do with capacity constraints at local level. Many provincial and local authorities are ill-equipped to drive the housing process in their area of jurisdiction and are struggling to respond to housing needs. Limited capacity constraints caused delays in Environmental Impact Assessment approvals, township establishment applications, the approval of the general plan and engineering designs, installation of services, approval and payment of subsidy contracts, etc.

A major challenge is housing affordability. The following table illustrates the loan affordability for different levels of monthly household income, based on a twenty-year loan repayable at prime (11%) plus 2% interest (as normally applies in the affordable market), with a 30% installment to income ratio.
The affordability challenge directly affects workers, especially when more than one member of the family is employed. The lower-middle class includes mine and quarry workers (R2122 per month), general clerks (R2 832 per month), motor vehicle artisans (R3361 per month), nurses and teachers (R3634 and R3953 per month respectively), secretaries, and police officers (R4409 per month).  

If one assumes a family of two adults and two children under ten with both adults working at the same rate, all these categories of worker fall into the housing affordability gap, earning too much to be eligible for the housing subsidy and too little to afford to house themselves adequately. In fact, this was a key issue raised by SAMWU president Petrus Mashisi as reason for the strike in late July 2009. The union’s demands included a 15% pay increase, a minimum wage of R5000 and a housing allowance of R3000. Speaking on Radio 702, Petrus Mashisi made the point that pay levels among SAMWU were such that they earned too much to qualify for a housing subsidy but too little to afford housing available on the market. A key justification for their wage increase demands was the cost of housing. The issue was raised again, a few weeks later, during the strike by members of the SA National Defense Force.

A key question, of course, is why is it not possible to build a house for less than R230 000? Research undertaken for the Department of Housing (Human Settlements) and the Banking Association in 2008, offered a number of hypotheses. Significantly, that report noted that builders and lenders were wary of offering an equivalent to the subsidy unit for sale, for fear of the commercial risk this would create as buyers with a twenty-year loan obligation realised that others were receiving the same house for free. The Department of Housing (Human Settlements) has estimated that on average, the government subsidised house currently costs R135 000 to build; but a household earning R5000 can only afford a loan of R128 033. This means that households earning between R3500 and just over R5000 cannot afford to buy the very same house that those earning less than R3500 get for free. If a financed house has to be built to a higher spec than a subsidised house in order to be saleable, then the building standards determined for the subsidised house make it impossible to build a non-subsidised

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1 Melzer (2007) The Middle Class in South Africa: Not a Black and White Issue. Presentation given at the Apartheid Museum, October. Per capita income in this instance draws on AMP5 2007 data, calculated from household income divided by household size (children under 10 count as half an adult)
2 Radio 702, 17:10 show, 28 July 2009.
3 Mail and Guardian, 4-10 September 2009
house for less than R200 000. Simply put, the specs applied to the government subsidised house price the next level up out of the affordability of the target market.

The report also highlights a range of other factors that impact upon the building process and the cost of the end, housing product. An important, and highly variable factor, is the cost of land and infrastructure. Specifically:

- **Land costs**: these vary from one area to the next given the prevailing market dynamics. Generally a R5000/stand price is used in proposals, based on a gross density of 30 units per hectare. However, this estimate bears no relation to market price and is at best a thumb suck. In some instances, public land is offered to a subsidised housing development through a land availability agreement for which the developer bears no cost. In other instances a developer may seek reimbursement for private land that they have borne holding costs for as they wait for the development approvals to come through. In still other cases, a developer may donate land in order to proceed more quickly with the development. In each case, the costed price of the land is less than the market would otherwise determine.

- **Bulk and land servicing costs**: for these, the Municipal Infrastructure Grant provides support, but rarely to the standard required. In many instances, municipalities seek further contributions towards bulk and land servicing from developers, as their existing systems (electrical substations, water works and sewage treatment plants) haven’t the capacity to take on the implications of a new development. In other developments, municipalities charge a fee towards future infrastructure demands. Consequently the costs of developing these bulk services must be accommodated in the project. In integrated developments, this is sometimes financed with a cross subsidy from the higher priced housing. Critically, the infrastructure fees paid for specific developments are often reflective of an investment that benefits the wider municipality, although the costs for this are borne by the development (and ultimately the buyers) alone.

Finally, developer margin also contributes to the price of a house. Margin is applied as a percentage item to cover the cost of finance (debt or equity), profit, and risk (closely linked to profit). Where the perceived risk of a project is higher (i.e. the developer expects that there will be various unforeseen items to be provided for, particularly in proclamation, or relating to theft during construction, or delays in statutory approvals), the risk pricing / margin is set higher. Some developers note the politically charged environment in which they operate and seek to ameliorate relations by reducing or even eliminating their margin. In this regard, their participation in the market is about keeping their company and its employees occupied rather than making a profit or growing their business. On this basis, however, their participation is likely to be short term until they find other, profitable opportunities.