Application of Regulatory Impact Analysis Methods to Proposed Regulatory Interventions Relating to the Urban Land Market

Overview Report

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GLOSSARY

DLA	Department of Land Affairs
CIS	Compulsory but incentive-synchronised approach to Inclusionary Housing
HDA	Housing Development Agency
IDP	Integrated Development Plan
IHP	Inclusionary Housing Policy
NDoH	National Department of Housing
RDP	Reconstruction and Development Programme
MIG	Municipal Infrastructure Grant
PHD	Provincial Housing Department
VPADD	Voluntary pro-active deal-driven approach to Inclusionary Housing

Executive Summary

In January 2007 the Urban Land Markets Programme (Urban LandMark) commissioned SBP to conduct a Regulatory Impact Analysis of two proposed regulatory interventions in the urban land market: the National Department of Housing's draft Inclusionary Housing Policy (IHP) and a proposal for the creation of a Housing Development Agency (HDA). In order to broaden the analysis, the HDA proposal was assessed as one possible option for improving access to affordable land for housing, the other being the creation of a Land Acquisition Fund (LAF).

The Inclusionary Housing RIA

The IHP proposal envisages the imposition of a requirement on private-sector housing developers that a stipulated percentage of new housing stock be set aside for affordable housing.

Options

At a project Reference Group meeting on 30 March 2007 it was agreed that two main ways of achieving this regulatory goal would be compared, as provided for in the draft IHP:

- the Compulsory but Incentive-Synchronised Approach (CIS) and
- the Voluntary Pro-Active Deal Driven Approach (VPADD)

The CIS approach envisages that, where the provision of a certain number of affordable units is prescribed as a condition of planning approval, the increased development costs resulting from such a requirement will be counter-balanced by various prescribed incentives, such as density concessions, expedited planning approval and tax breaks.

The VPADD approach envisages a situation where municipalities and private-sector developers would proactively identify projects in which affordable housing could be provided as a component of the overall development. Such projects would proceed even in the absence of a regulatory requirement that a certain percentage of units be set aside for affordable housing in the area concerned.

Key assumptions

The comparative assessment of the costs and benefits of these two options was complicated by the difficulty of estimating the number of market-related housing units that will be delivered after implementation of the IHP, whichever option is followed. The

study assumes that 30 000 of the 68 000 housing units currently produced by the private sector every year in South Africa will be subject to the IHP. This would mean that roughly 10 000 affordable units will be produced if the target of 30% affordable units is met. The study further assumes that the overall number of market-related units produced will not increase as a result of the implementation of the IHP, i.e. that the market will not replace the 10 000 units produced by way of the IHP.

Another key assumption concerns the extent to which housing developers' profit margins will be reduced in relation to affordable units. Since reduced profit margins are a form of compliance cost, any reduction in profit margins will result in an increase in the overall compliance costs of the IHP. The study found that, if compliance costs are matched by incentives, the benefit:cost ratio of the policy will remain constant at roughly 1.06, i.e. for every R1.00 spent on implementing the IHP, R1.06 in economic benefits to society will accrue, whichever option is implemented. However, as soon as the level of incentives drops below 90% of the compliance costs of the IHP, the benefit:cost ratio drops below 1, i.e. the implementation of the policy will entail a net cost to society in economic terms.

Cost effectiveness

Since the risk that incentives will not match compliance costs is higher in relation to the CIS option than the VPADD option, this seems to suggest that the VPADD option will be more cost-effective. However, the study further finds that the administrative costs associated with the VPADD option are likely to be higher than for CIS option because of the additional training required to capacitate municipal officials to implement the VPADD option. At a certain point, the increased administrative costs of training municipal officials to implement the VPADD option will outweigh the benefits flowing from this approach. This being the case, neither the CIS nor the VPADD option can be said to be more cost-effective in the abstract. The NDoH's policy of pursuing both options simultaneously is accordingly to be commended.

Because of the sensitivity of the proposal to existing municipal capacity, the study predicts that the VPADD option will be more cost-effective where municipal capacity is **high**, as the matching of incentives to costs of compliance will in this instance occur at no significant increased cost to the state. Where municipal capacity is **low**, on the other hand, the study predicts that the CIS option will be more cost-effective, as any reduction in benefits associated with failing to match incentives to the costs of compliance is likely to be off-set by the costs of improving municipal capacity. Where it is not possible to improve municipal capacity to the level required, or until this occurs, the CIS option will be preferable.

Risk assessment

The economic analysis suggests that it is possible to implement the IHP in a manner that entails no net cost to society. This finding, however, depends on a number of assumptions that may not be borne out in practice. These include:

- the ability of officials even in well-capacitated municipalities to implement the VPADD option;
- the ability of municipalities, within the constraints of their existing budgets and functions, to provide sufficient incentives to match the compliance costs to developers, particularly small (BEE) developers who are likely to be hardest hit;
- the feasibility of some of the incentives proposed, especially that of expedited planning approval processes, without incurring either considerable additional administrative costs or unfairly prejudicing developers whose applications do not fall under the IHP;
- the capacity of government to prevent downward raiding of affordable units produced as part of the IHP and to enforce developers' obligation to make the units available to the appropriate beneficiary class;
- access by the beneficiaries of the IHP to appropriate social infrastructure, failing which the capacity of government to continue to subsidize the living expenses (schools, health, transport) of the beneficiaries of the IHP and to contain any political disaffection that may ensue from so doing; and
- the capacity of the NDoH to align the IHP with existing inclusionary housing initiatives at provincial and local government level.

The possibility that one or more of these assumptions will not be borne out in practice represents a risk to the success of the proposal that may affect the otherwise positive results of the economic analysis.

Access to Affordable Land for Housing RIA

The NDoH's policy on accessing affordable land for housing envisages the creation of a government-funded Housing Development Agency (HDA) that would proactively acquire land for housing development.

During the consultation process, it became clear that the establishment of an HDA is still contested within government, with National Treasury questioning the need to create a national agency to perform a function that is currently assigned to municipalities.

It was accordingly decided to compare the option of creating an HDA against an alternative option of creating a Land Acquisition Fund (either at national or at municipal level) to subsidize the costs of acquiring well-located land for affordable housing.

Critical assumption: Reduced transport costs as outcome

The study indicates that the success of both the HDA and the LAF options in economic terms is highly dependent on whether these options result in a reduction in transport costs for participating beneficiaries. If this assumption is not borne out, the cost-benefit analysis suggests a break-even point at approximately -2.5km, i.e. where the policy results in housing beneficiaries having to travel 2.5km *further* than they otherwise would have, the costs to the state of subsidising the acquisition of high-value land together with other implementation costs will be exactly off-set by the benefits received by the private sector. Under this scenario, the policy question in respect of both options reduces to whether the state wishes to spend an estimated R245 million in implementation costs on providing 38 000 households with affordable housing.

Additional information required

The further value of the study is that it indicates what additional information is required before proceeding with the proactive acquisition of land for affordable housing. Most importantly, the NDoH requires better statistics than it currently has on average land values. Such information is needed in order to make a more precise estimate of the 'land loss figure', i.e. the subsidy cost to the state of making available well-located land for affordable housing. Without this information, the proposal is impossible to cost. All that can be said is that the benefit:cost ratio of the proposal declines as the loss on sale of land figure increases. For example, if the loss per square metre on the sale of land is R53.00 (meaning that the state must subsidise the acquisition of land at R53.00 per square metre in order to make it available for affordable housing) the benefit:cost ratio is 3.76. This means in effect that R3.76 in value will accrue to the economy (largely in the form of reduced transport costs) for every R1.00 spent on the proposal. However, if the loss on sale of land increases to R146.00 per square metre, the benefit:cost ratio declines to 2.13.

Before proceeding with the proposal, the NDoH should endeavour to obtain a more reliable estimate of the land loss figure. In particular, it is suggested that access to the ABSA residential property market database be requested for this purpose.

Risk assessment

As with the Inclusionary Housing proposal, the economic assessment of the access to affordable land for housing proposal depends on a number of assumptions that may not be borne out in practice. These include:

- that the HDA will be well-capacitated and able to bring to bear sophisticated skills currently lacking at local and provincial level in identifying appropriate land for purchase, negotiating with developers, and fast-tracking approval processes;
- that the NDoH will be able to co-ordinate the activities of the other national departments involved (the Department of Land Affairs and the DPLG) and the provinces and municipalities integral to the success of this proposal;
- that a proactive role in this respect on the part of the NDoH will not be challenged by other organs of state as being constitutionally inappropriate;
- that the HDA will not undermine the existing role of strong municipalities in the acquisition of land for affordable housing, or permanently disable weaker municipalities from building this capacity;
- that the replacement of the Development Facilitation Act by the DLA's proposed Land Use Management Act will not fundamentally change the policy parameters for this proposal;
- that the cost of subsidising the acquisition of high-value land for affordable housing, including the ongoing subsidisation of beneficiary living costs to prevent downward raiding, will be sustainable in the long run;
- that the anticipated benefits of reduced transport and other costs associated with beneficiaries' living closer to their places of employment will in fact be realized;
- that the HDA's land acquisition, management and infrastructure development function will be clearly distinguished from the private sector's top-structure development function such that the HDA will not be seen to be in competition with the private sector; and
- that the benefits of state subsidization of land acquisition will be passed on to housing consumers rather than private sector developers or the HDA itself.

The possibility that one or more of these assumptions will not be borne out in practice represents a risk to the success of the proposal that may affect the otherwise positive results of the economic analysis.

Overview Report

1. Background

In January 2007 the Urban Land Markets Programme (Urban LandMark) commissioned SBP to conduct a Regulatory Impact Analysis (RIA) of two proposed regulatory interventions in the urban land market ('the project'), under consideration in the National Department of Housing (NDoH), This document provides an overview report for the project.

It is necessary to stress that whilst the SBP-led team received the full cooperation of the NDoH, SBP was not contracted by the NDoH as such to conduct RIAs on these two proposals. The report was commissioned by Urban LandMark with the objective of assisting the NDoH in developing the proposals.

In discussion with Urban LandMark and the NDoH, the two proposals chosen for analysis were the Department's draft Inclusionary Housing Policy (IHP) and a proposal for the creation of a Housing Development Agency (HDA).

The IHP proposal involves the imposition of a requirement on private-sector housing developers serving the upper end of the market that a stipulated percentage of new housing stock should be set aside for affordable housing. The HDA proposal envisages the creation of a government-funded agency that would proactively acquire land for housing development.

Urban LandMark's primary concern is the impact of regulatory interventions in the South African urban land market on the poor. The two RIAs accompanying this report accordingly focus on this issue in particular.

2. Brief introduction to RIA

Regulatory Impact Analysis (RIA) is employed in a growing number of countries as a key instrument in the development of better regulation. Assessing regulatory impacts in terms of risks, costs and benefits against selected quantitative and qualitative indicators, including economic, social and environmental impacts, the approach can be applied both to new regulatory proposals (prospective RIA) and to existing regulation (retrospective RIA).

Broadly speaking, RIA is undertaken at successive stages during the policy-making and regulatory process – from the initial recognition of a problem that might require a regulatory response, to a mid-level RIA used to decide between different policy options, and a final RIA justifying the eventual regulatory choice. The RIA statement typically includes consideration of:

- the purpose and intended effect of the proposal;
- options for dealing with the problem identified (including non-legislative options) and the costs and benefits of each option;
- compliance costs for business and society;
- implementation costs for government;
- mechanisms for enforcement, the cost of enforcement, and probable level of compliance;
- possible unintended consequences; and
- impact on particular groups, especially vulnerable groups, such as the poor, or small businesses.

Regulations often extend beyond the field they actually regulate. Systematic RIA helps to determine the likely outcomes of regulatory proposals, including unintended impacts, following consultation with all affected groups. Specific benefits include:

- Improving the quality and efficiency of government interventions, by increasing and improving the quality of the information brought to bear on the policy-making and regulatory process.
- Enhancing competitiveness by thinking through the unintended consequences of proposals, and ensuring that regulations are appropriate and proportional.
- Increasing transparency and accountability, by requiring drafters of policy and regulations to set out the reasons for their decisions, demonstrate how the proposals address an identified and quantified problem, and communicate the anticipated costs and benefits.
- Providing a benchmark for monitoring and evaluation post-implementation.
- Encouraging consideration of the full range of options available and more imaginative use of alternatives to regulation.
- Careful thinking through of implementation and enforcement mechanisms.

The RIA process may also strengthen and open up consultation – across departments, with key stakeholders, and with the wider public. The RIA process treats consultation as an information-gathering opportunity from the earliest stages, engaging stakeholders to seek opinions and factual data to inform the selection of options and the detail of

regulatory provisions and implementation proposals. RIA statements are generally made publicly available to ensure the transparency of the decision-making process.

In summary, RIA aims to support better informed, better costed, and enforceable mechanisms for achieving policy goals. To this extent, high-level political commitment is crucial if RIA is to be successfully implemented, and strong leadership at the central and departmental levels is critical to its success.

3. RIA in South Africa

In 2005 the Presidency and National Treasury commissioned a consortium led by SBP to undertake a feasibility study of the application of RIA in South Africa. The project entailed a thorough review of the current South African regulatory system at the national level, identifying gaps and weaknesses in existing processes and exploring ways in which RIA could potentially address these.

The SBP-led team, which included the consultants engaged in the present project, developed a set of RIA instruments and processes specific to the South African context and reflective of national government policy priorities, with input from a broader reference group. These tools were piloted in two national departments (dti and DEAT). The pilots proved to be useful and illuminating in assessing the regulatory process, as well as the content of actual legislative proposals.

Following the pilots, the project team, with Presidency and Treasury input, produced a set of institutional and procedural options for the implementation of RIA in South Africa, which would enable RIA to build on the existing regulatory system while addressing identified weaknesses and poor coordination across government.

In his State of the Nation address in January 2006, President Thabo Mbeki included a commitment to improve the regulatory climate, as part of an 'overall programme to introduce a regulatory impact assessment system to enable the government regularly to assess the impact of its policies on economic activity in our country.' He affirmed this commitment in January 2007.

The proposal for the introduction of RIA was formally approved by Cabinet in early 2007. The system will be introduced at the national level on a pilot basis over the next two years. It is recognised that departments are likely to come on board at different times according to their capacity to undertake this type of analysis. The model at national level

will address capacity concerns by providing for support and advice from a central RIA function, based in the Cabinet Office in the Presidency, with strong technical support from National Treasury.

4. Methodology

4.1 Reference Group

Successful RIA requires buy-in and ownership by the affected department. In order to ensure that the NDoH was closely engaged in the project, a small reference group was established, comprising relevant senior officials within the Department, together with a few key external stakeholders, to provide detailed input during information-gathering and reporting.

Reference group members were interviewed individually during the consultation phase. The group met as a whole for the first time on 30 March 2007. The first reference group meeting provided an opportunity to discuss RIA and its application in the Department, and to gather detailed input and feedback from reference group members on two draft RIAs.

The two draft RIAs were revised in light of comments received at this meeting, and presented a second time to the reference group on 2 May 2007, when the main findings of the project, in particular the risks associated with each proposal, were discussed.

4.2 Consultation

The timescale and budget for this project precluded a full-scale public participation process. Instead, consultation took the form of a series of 20 face-to-face interviews with key government officials, developers, housing sector experts, economists, NGOs and other key informants. The consultation process sought both general views on the two regulatory proposals under review, as well as data on likely impacts and unintended consequences. The detailed consultation report is attached (Annexure A).

4.3 Options development

As with any RIA, it was necessary to test, in respect of each regulatory proposal, various methods of achieving the proposed regulatory goal and their associated costs and benefits. In the case of the IHP, it was relatively easy to identify options as the NDoH's policy process had all along considered different regulatory methods, which eventually crystallised into two main options mid-way through the project. The RIA introduced in

section 5.1 of this report is based on these two options, together with a standard no-new-regulation option.

The proposal relating to the creation of an HDA was harder to divide into options as the NDoH seemed to have settled on a single regulatory option quite early on in the process. This is in fact quite typical of departmental practice in South Africa, and is one of the aspects of the existing regulatory system that the introduction of RIA may be expected to change. The problem with settling on a single regulatory option, as pointed out in the Presidency/National Treasury report mentioned in section 3 above, is that this way of proceeding precludes consideration of potentially viable alternatives. In consequence, the regulatory process becomes closed and defensive of a single, preferred option, rather than open and inquisitive about the best method of achieving the regulatory goal.

In order to combat this problem, the RIA introduced in section 5.2 renames the proposal relating to the creation of an HDA the 'access to affordable land for housing' proposal, and then analyses the NDoH's preferred option for achieving this goal (the creation of an HDA) alongside two hypothetical options: the creation of a land acquisition fund (with no HDA) and the standard 'no-new-regulation' option, which in this instance contemplates fine-tuning the existing mechanisms through which government acquires land for affordable housing. Although the latter two options are not formally being considered by the NDoH, they may assist in throwing the costs and benefits of the HDA option into sharper relief.

4.4 Economic analysis

Drawing on the results of the departmental and stakeholder consultation processes, and the identification of objectives and various sub-options to be considered, economic analysis was undertaken to assess the likely impacts, costs and benefits of the identified options. The RIA template developed in the Presidency/National Treasury project was used as the framework for this analysis. Economic models capable of extrapolating the likely costs and benefits (both social and economic) to society of each option were constructed, based on the information gathered and discussions with members of the project team who had been involved in the stakeholder interviews. The project team, consisting of one lawyer, two policy analysts and two economists, met as a group on three occasions during the course of the project to exchange information and ideas. In this way, every effort was made to ensure that the economic models were constructed on realistic assumptions about the policy options and the best available economic data.

However, South Africa is an information scarce environment when compared to the OECD countries, and the actual numbers generated by the economic analysis must thus

be treated as indicative only. For example, there is no readily accessible, countrywide database of land values in South Africa, which made it extremely difficult to calculate the likely costs of acquiring land for affordable housing. There are also some detailed policy decisions to be made within the various regulatory options under consideration which have important bearing on the eventual costs and benefits of the regulations. For example, there is as yet no clear indication of the market segment/s to be focused on by the proposed Housing Development Agency and hence it is not clear exactly how many units or how much land will be addressed by the Agency. Similar considerations apply to the Inclusionary Housing Policy.

5. Overview of the two RIAs

5.1 Inclusionary Housing RIA

5.1.1 Background

The development of the NDoH's Inclusionary Housing Policy (IHP) can be traced back to the Comprehensive Plan, where the 'introduction of mechanisms such as residential development permits' is mentioned as one of three proposed interventions in section 3.2, on 'Promoting Densification and Integration'. Since the adoption of the Comprehensive Plan, the IHP has gone through a long policy development process, with private sector housing developers initially expressing considerable opposition. Attitudes towards the IHP began to change in January 2007 after statements from the NDoH indicating that any new regulatory burdens imposed on developers by the policy were likely to be off-set by incentives. The latest version of the policy is contained in an internal NDoH document entitled 'Inclusionary Housing Policy (IHP) in South Africa' and dated February 2007. The RIA prepared for this project is primarily based on this document, but also takes into account earlier policy statements and information gathered by the NDoH to the extent that such statements have not clearly been superseded by the February 2007 document. In addition, the RIA is based on the key informant interviews conducted by the project team, additional information gathered by the economists working on this project, and feedback received from the Reference Group meetings.

5.1.2 Structure

The Inclusionary Housing RIA follows the framework developed by the project team during the Presidency/National Treasury Project. This framework was in turn loosely based on the framework used by the UK Cabinet Office's Regulatory Impact Unit. The main adaptation made to the UK framework is the insertion of an additional section, section 8, which consists of a table comparing the costs and benefits of the different

options against 11 overarching policy criteria specific to South Africa. These criteria include such issues as BBBEE impacts, racial equity and poverty reduction. The poverty reduction benefits of the various Inclusionary Housing options are further addressed in the benefits section of the RIA document (section 6).

The RIA begins by stating the title of the proposed measure as being 'the Inclusionary Housing Bill (to be introduced by the National Department of Housing)'. As far as the project is aware, this bill has not yet been formally drafted. However, section 18 of the IHP Policy document of February 2007 states that 'New legislation will be created to operationalise the National Inclusionary Housing Policy'. Since the proposed legislation will, inter alia, coordinate the work of all three spheres of government, we have assumed that it will take the form of a bill introduced in the National Assembly by the Minister of Housing, and that the principles informing the bill will largely correspond to the principles articulated in the draft IHP Policy of February 2007. Any amendments to provincial or local government planning legislation that may be introduced in the course of implementing the national bill will constitute separate regulatory interventions, but their overall impact can be assessed in general terms in this RIA. In this sense, the Inclusionary Housing RIA prepared for this project is similar to a framework legislation RIA as defined in the Presidency/National Treasury project.

Given the stage that the policy development process for the IHP has reached, the RIA conducted for this proposal would ordinarily have been a mid-level RIA prepared as part of the Cabinet approval process. However, the absence of an initial RIA, the paucity of the economic data available, and the fact that there are many policy variables still to be determined, mean that the RIA prepared for this project is probably best considered as an initial RIA of the kind prepared at the outset of the regulatory process. The value of such an RIA is not so much the economic numbers it generates, but the gaps in the policy development process it identifies for further specification. We explain this issue in more detail in section 6 below ('Main Findings').

The next section of the RIA is headed 'Purpose and Intended Effect of Proposed Measure' and is divided into subsections on 'the background to the problem' and 'the objective'. In accordance with international RIA practice, we have tried to capture these two issues as succinctly as possible. In doing so, we have been guided by the various statements of the purpose and intended effect of the IHP in the NDoH's own policy documents, but have not reproduced these statements in their entirety. Rather, we have translated the NDoH's documents into 'RIA-speak' – a deliberately compressed style that attempts to convey just the essence of the regulatory problem identified and the desired policy objective.

Although RIA can sometimes appear to be a highly technical form of policy analysis, it is important to remember that the policy objective is always defined politically, and that RIA does not aim to alter the objective of a regulatory proposal, only to assess the best means of achieving it.

The risk assessment section of the RIA, section 3, typically states the risks attendant on failing to address the problem identified in the previous section. The purpose of this section is to alert political decision-makers to the urgency of the proposed measure, and to the likely consequences of not taking action. We have adapted this format somewhat in both RIAs by including consideration not just of the risks of failing to address the problem, but also of the risks of addressing the problem in the manner envisaged. These latter risks are typically referred to as the 'unintended consequences' of regulation. Risks are also addressed under 'enforcement and sanctions,' where they relate to under-enforcement or inappropriate means of enforcement.

In respect of the Inclusionary Housing RIA, the risk of unintended consequences mainly has to do with the accuracy of the policy's underlying assumptions about government's capacity to match private sector developer incentives to the regulatory burdens imposed. This was a key issue that emerged during the consultation process, with many of those interviewed telling us that they had no objections to the IHP in principle, but that they were concerned about its impact on private sector housing development. The particular concern was that the IHP, in its implementation rather than conceptualisation, would fail to match incentives to regulatory burdens, and thus drive private sector developers out of the market, not just for affordable housing, but also for up-market housing, on which the success of the IHP depends. The section on costs in the RIA (section 5) takes this particular risk into account by subjecting the assumption that developer incentives can be made to match regulatory burdens to a sensitivity analysis. For example, where the IHP proposes that municipal officials will draft 'local IHP Plans' that match burdens to incentives, the default assumption is that this will in fact happen. The sensitivity analysis investigates the implications for the policy should this assumption prove to be false, and shows how the benefit:cost ratio of the proposal declines as the burdens on developers begin to outweigh the incentives provided.

The risk that local IHP Plans will not achieve a balance between incentives and costs both a policy variable and an implementation variable. A related risk is the development and application of varying standards for IHP across different municipalities. While consultation responses underline the importance of flexibility at local level, to ensure that IHP schemes are appropriate for the local context and structured so as to be feasible for

developers, it was also clear that some broad national parameters are needed, to ensure consistent standards across different areas and avoid the risk of partial implementation.

5.1.3 Choice of options

The first draft of the Inclusionary Housing RIA was based on three regulatory options as identified by Professor Dan Smit on behalf of the NDoH, for discussion with industry stakeholders. At the Reference Group meeting on 30 March 2007 it was noted that the NDoH has since moved beyond these three options, and is currently considering only two options: a Compulsory but Incentive-Synchronised Approach (CIS) and a Voluntary Pro-Active Deal Driven Approach (VPADD). The first approach envisages that, wherever the provision of a certain percentage of affordable units is prescribed as a condition of planning approval, the increased development costs or reduced profit margins resulting from such a requirement will be counter-balanced by various incentives, such as density concessions, expedited planning approval and tax breaks. The second approach envisages a situation where municipalities and private-sector developers would proactively identify projects in which affordable housing could be provided as a component of the overall development. Such projects would proceed even in the absence of a regulatory requirement that a certain percentage of units be set aside for affordable housing in the area concerned.

In strict RIA terms, these two approaches do not represent separate regulatory options, but separate components of a single regulatory strategy in terms of which voluntary deals will be allowed to proceed while the compulsory element of the strategy is put into place. To cost such a strategy, one would ordinarily need to know what proportion of the overall affordable housing units delivered per year the NDoH anticipates would in the end be delivered through CIS as opposed to VPADD. In addition, since it is envisaged that CIS would progressively replace VPADD in some areas, it would be useful to know what the anticipated rate of substitution of VPADD by CIS is. Neither of these issues is clear from the IHP Policy document of February 2007. It is thus impossible to assess the costs and benefits of the combined strategy. Instead, for purposes of the Inclusionary Housing RIA, CIS and VPADD are treated as alternative regulatory options. This approach allows the costs and benefits of the two components of the strategy to be separately assessed. This may in turn assist the NDoH in deciding on how rapidly to introduce CIS and how far to take it. Ultimately, the best regulatory strategy will consist of the right mix of CIS and VPADD, with CIS only being introduced in areas where sufficient incentives can be provided.

In addition to CIS and VPADD, the Inclusionary Housing RIA considers the feasibility of a third, 'no new regulation' approach. Although this option is no longer seriously being considered by the NDoH, it is included for purposes of comparison.

5.1.4 Costs and benefits

The comparative assessment of the costs and benefits of the three inclusionary housing options is complicated by the difficulty of estimating the number of market-related housing units that will be delivered after implementation of the IHP, whichever option is followed. At present, an average of 68 000 housing units are produced by the private sector every year in South Africa, of which about 30 000 are market-related and hence subject to the IHP. The first key assumption in assessing the costs and benefits of the IHP relates to how many market-related units will be produced if the target of 30% affordable units is met. On one assumption, the meeting of this target will reduce the number of market-related units produced by the private sector by the same amount, i.e. roughly 10 000 units. On another assumption, the market will continue to demand the same level of supply of market-related units, with the 10 000 affordable housing units being produced in addition to the market-related units currently being produced. The RIA as it currently stands is based on the first assumption, i.e. that the number of market-related units produced will decrease in line with the number of affordable units produced.

Another key assumption concerns the extent to which housing developers' profit margins will be reduced in relation to affordable units. Since reduced profit margins are a form of compliance cost, any reduction in profit margins will result in an increase in the overall compliance costs of the IHP. Provided that these increased compliance costs are matched by incentives, the benefit:cost ratio of the policy will remain constant at roughly 1.06, i.e. for every R1.00 spent on the implementation of the IHP R1.06 in benefits will accrue. This is true whichever option is implemented. It is fair to assume, however, that the risk that incentives will not match compliance costs to developers is higher in relation to the CIS option than the VPADD option. This may be significant in deciding between the two options. As demonstrated in the RIA, as soon as incentives fall below 90% of the cost of compliance, the benefit: cost ratio of the policy falls below 1. The risk of this occurring is greater in respect of the CIS option, resulting in the overall costs in economic terms to government and the private sector of implementing the IHP outweighing the quantifiable economic benefits. While this does not mean that the CIS option should not be pursued, there is a risk that this option will not pay for itself, i.e. that the non-quantifiable social benefits flowing from this option will only be achieved at a net cost to society in economic terms. This may well be a price that government is prepared to pay for these benefits, and thus the CIS option may still be justified in political terms.

However, since the same social benefits can be achieved by pursuing the VPADD option, with a lower risk of the benefit:cost ratio falling below 1, the VPADD option appears to be the more cost-effective of the two options.

However, as indicated in section 5.2.2 of the RIA, the administrative costs associated with the VPADD option are likely to be higher than in respect of the CIS option. This is because, under the VPADD option, the terms of each inclusionary housing project, including the way in which incentives match compliance costs, will have to be separately negotiated. At a certain point, the increased administrative costs of matching incentives to compliance costs may outweigh the benefits attendant on achieving an exact balance.

It is therefore not possible at this stage to say which of the two options (CIS or VPADD) is more cost-effective. This being the case, the NDoH's policy of pursuing both options simultaneously is to be commended. The success of the IHP lies less in making a final policy choice between these two options than in deciding which to employ in a particular situation. Where municipal capacity is high, the VPADD option is likely to be more cost-effective, as the matching of incentives to costs of compliance will occur at no significant increased cost to the state. Where municipal capacity is low, the CIS option may be preferable, as any reduction in benefits associated with failing to match incentives to the costs of compliance is likely to be off-set by the costs of improving municipal capacity. Where it is impossible to improve municipal capacity to the level required, or until this occurs in respect of any particular municipality, the CIS option would appear to be preferable.

5.1.5 Comparative assessment of regulatory options

Section 8 of the Inclusionary Housing RIA consists of a table comparing the likely impact of the three regulatory options in respect of a number of priority areas for government. This qualitative assessment reveals no significant differences between the CIS and VPADD options apart from a slight difference with respect to geographical distribution. In respect of this indicator, the qualitative assessment confirms the outcome of the cost-benefit analysis that the VPADD option is likely to have a greater impact in 'urban areas that already have significant municipal capacity'. As might have been expected, the qualitative assessment of Option 3 (no new regulation) indicates no significant impacts on any of government's priority areas.

5.1.6 Enforcement and sanctions, monitoring and evaluation, consultation

Sections 7 and 8 of the RIA on enforcement and sanctions, monitoring and evaluation are necessarily underdeveloped at this initial stage, but do highlight certain key points.

In relation to enforcement and sanctions, the key point is that mechanisms need to be put in place to ensure that the IHP benefits its intended target group. This largely entails enforcing developers' obligations to rent or sell units to the appropriate housing beneficiaries. Municipal capacity also emerges here as a key enforcement issue, under both the CIS and VPADD options. In the first case the enforcement issue is mandatory compliance; in the second, the provision of incentives.

Given the stress placed in the RIA on the effects of failing to match incentives to compliance costs, as well as the way in which increased administrative costs may affect which option is more cost-effective, these two issues will need to be monitored closely during the implementation process. It is envisaged that the IHP will be implemented progressively, and that the first year of implementation will be used to gather information on the circumstances under which the CIS option outperforms the VPADD option and vice versa.

5.2 Access to Affordable Land for Housing RIA

5.2.1 Background and choice of options

Section 3.4 of the Comprehensive Plan envisages the proactive acquisition of well-located land for housing development. There is no mention in this or any other section of the Comprehensive Plan of the creation of a Housing Development Agency. In fact, the Plan specifically says that 'all land will be acquired by municipalities in line with Municipal Integrated Development Plans (IDPs), Spatial Development Frameworks and will be made available for housing development in line with the Housing Chapter of IDPs' (p. 14). Since the adoption of the Plan, however, the NDoH has increasingly focused on what early policy documents referred to as a Special Purpose Vehicle (SPV), and what later documents call a Housing Development Agency (HDA), as the mechanism through which land will be proactively acquired for housing development.

During the course of the consultation process for this project, it became clear that the establishment of an HDA is still contested within government. National Treasury in particular has called on the NDoH to demonstrate a strong business case for the HDA, including a clear rationale for establishing a national agency to perform a function that is currently assigned to municipalities.

The RIA method works best when it is applied to one or more competing regulatory options. It was accordingly decided to conduct the RIA as though the more broadly conceived policy in the Comprehensive Plan of acquiring land for affordable housing had not yet been narrowed down to the HDA policy option. In order to do this, two

hypothetical regulatory options were invented for purposes of comparison: the Creation of a Land Acquisition Fund (without an HDA) and the standard, no-new-regulation option.

The first alternative option is based on a statement in the Comprehensive Plan that the funding of land acquired for housing should be de-linked from the housing subsidy (p. 14). Although that statement does not itself envisage the creation of a separate fund, something like this policy option was suggested during the development of the IHP. According to the March 2007 version of the IHP, developers who are exempted from providing affordable housing as part of a particular development (because the average cost of the units in that development is too high and an off-site development may not initially be possible) will be required 'to pay a fee in lieu of building the required inclusionary units' (p. 14). Professor Dan Smit, in his Powerpoint presentation to the NDoH, had suggested that these payments could be transferred to a 'local government land acquisition fund' (Dan Smit 'NDoH presentation' slide 43). The March 2007 version of the IHP drops this idea, and instead proposes that such payments should be treated as general revenue. Nevertheless, Professor Smit's idea suggests that many of the objectives of the HDA option could be achieved by creating a Land Acquisition Fund.

The primary objective of the Access to Affordable Land for Housing proposal is to facilitate the acquisition of well-located land for housing development. At present, the main obstacles are the high cost and scarcity of such land, and a lack of capacity on the part of some municipalities to take proactive steps to acquire land in their area of jurisdiction. The creation of a dedicated HDA, with its own separate funding stream, is one way of addressing this problem, but has the disadvantage that it may cut across existing municipal land acquisition strategies, interfering with the work of larger municipalities who already have systems in place to acquire land for housing development, and removing this function from smaller municipalities, rather than assisting them to perform it better. In the circumstances, the project team decided that it would be useful to consider whether the regulatory goal of acquiring land for housing development could be achieved through the creation of a Land Acquisition Fund. If the costs and benefits of this option are shown to be similar to or better than the costs and benefits of creating a Housing Development Agency, the creation of a Land Acquisition Fund, which promises to produce fewer unintended consequences, may be preferable. Even if the option of creating a Housing Development Agency is preferred, a comparison between the two options helps to isolate the specific costs attendant on the creation of such an agency. These costs need to be justified on the basis of the HDA's greater efficiency and effectiveness in acquiring land for housing development.

The third option considered in the Access to Affordable Land for Housing RIA is the standard 'no-new-regulation' option. This option envisages the fine-tuning of existing mechanisms through which municipalities acquire land for housing development, without the creation of a separate Land Acquisition Fund. This is not a realistic option, since the policy commitment to change the existing system has already been made, but it is nevertheless worth considering for purposes of comparison.

5.2.2 Structure

The structure of the Access to Affordable Land for Housing RIA is the same as that for the Inclusionary Housing RIA.

5.2.3 Costs and benefits

Standard RIA practice requires that a cost-benefit analysis be conducted for each option under consideration, at least by the time a final RIA is produced. For various reasons, it was not possible to follow this format for the two RIAs conducted for this project. In the case of the Access to Affordable Land for Housing RIA, it was not possible in the time available to obtain data on the costs and benefits of option 3 (fine-tuning the existing demand-driven model). The costs and benefits of option 2 (the creation of a land acquisition fund) do not differ significantly from the costs and benefits for option 1 (the creation of an HDA), the main difference between these two options being reduced administrative costs for option 2. In the circumstances, the cost/benefit summary in section 7 of the RIA summarises the costs and benefits of option 1 only. It has therefore not been possible to compare the net costs and benefits of the three options.

Sections 5, 6 and 7 of the RIA indicate the sensitivity of the NDoH's preferred option (the creation of an HDA) to the underlying assumptions, especially assumptions relating to implementation. The cost-benefit analysis of option 1 indicates that the success of this option in economic terms (i.e. benefits will outweigh costs) is highly dependent on the correctness of the assumption that this option will lead to a reduction in transport costs. As noted in section 7 of the RIA, there are some indications in the literature that this assumption may not in fact be correct, and that well-located land may be associated with higher transport costs in certain cases, whilst land on the periphery may in some cases be associated with lower transport costs. This indicates that the estimates in the RIA of the likely benefits of the HDA option may not be realised in practice. Without these benefits, the cost-benefit analysis of the HDA option suggests a break-even point at approximately -2.5km (i.e. where the adoption and implementation of the HDA option results in beneficiaries having to travel 2.5km *further* than they otherwise would have). At this point, the costs to the state of subsidising the acquisition of high-value land

together with other implementation costs will be exactly off-set by the benefits received by the private sector in being able to acquire well-located land at less than market value. Under this (not unlikely) scenario, the policy question in relation to the HDA option reduces to whether the state wishes to spend R245 million in implementation costs on providing 38 000 households with affordable housing.

The cost-benefit analysis shows that additional information is required in order to complete a mid-level and final RIA. In particular, there is a clear need for better information on land values, which will in turn allow a more precise estimate of the 'land loss figure', i.e. the subsidy cost to the state of making available high-value, well-located land for purposes of affordable housing. The RIA indicates how the cost-benefit ratio of the HDA proposal declines as the loss on sale of land figure increases. If the loss per square metre on the sale of land is R53.00 (meaning that the state must subsidise the acquisition of this land at R53.00 per square metre in order to make it available for affordable housing) the cost-benefit ratio is 3.76 (meaning that the benefits of the proposal will exceed costs in that ratio, i.e. that for every R1.00 spent on the proposal at the scale envisaged R3.76 in benefits will accrue). As the loss on sale of land increases to R146.00 per square metre, the cost-benefit ratio declines to 2.13 (i.e. for every R1.00 spent on the proposal at the scale envisaged R2.13 in benefits will accrue).

These figures suggest that before proceeding with establishment of the HDA the NDoH should obtain a more reliable estimate of the land loss figure. In particular, it is suggested that access to the ABSA residential property market database be requested for this purpose.

5.2.4 Comparative assessment of regulatory options

As indicated earlier, this section of the RIA attempts to assess the implications of the three options under consideration in relation to certain over-arching policy imperatives. The analysis here is qualitative, with the likely implications of each option being set out in summary form in a table. In some cases (as in the assessment of economic growth impacts, for example), all three options appear likely to advance government's overarching policy objectives in respect of the criterion specified. In other cases, such as poverty reduction, two of the options have clear positive implications whereas the other does not. Overall, creation of an HDA has mainly positive implications. The two exceptions are its implications for competition, where there is a risk that the HDA will compete directly with the private sector in respect of housing provision, and its implications for income distribution, where there is a risk that the provision of high-value, well-located land at subsidised rates may be seen as unfair by housing beneficiaries whose land costs were not subsidised in this way. Both of these risks are discussed in

greater detail in the RIA. The qualitative assessment indicates that options 1 and 2 will have largely positive implications for government's over-arching policy imperatives. Option 3 has fewer obvious positive implications, but, as might be expected for such a cautious option, also fewer obvious negative implications.

5.2.5 Enforcement and sanctions, monitoring and evaluation, consultation

It may be surmised even at this early stage that the major enforcement challenges for the Access to Affordable Land for Housing policy will be: (a) the prevention of downward raiding; and (b) ensuring that state subsidies in respect of land acquisition are passed on to housing beneficiaries rather than developers. In line with the discussion of implementation variables in the cost-benefit analysis, the major Monitoring and Evaluation issue will be periodically to check that the policy actually results in beneficiaries living closer to their place of work. As pointed out in section 5.2.3 above, the benefit:cost ratio of option 1 rapidly declines to the extent that this is not the case.

6. Main findings

This section summarises the main findings of the consultation process and the two RIAs as follows:

6.1 Inclusionary Housing Policy

The consultation process in respect of the IHP identified eight main findings that are discussed in more detail in Annexure A. In summary, these points are:

- The IHP is unlikely to deliver affordable units at scale but may fulfil a niche role in the NDoH's menu of housing options.
- There may be a need for ongoing subsidisation to enable poorer households to continue living in affordable units.
- The success of the IHP depends on flexible implementation at the local level, within the context of broad national parameters.
- If the obligation to find appropriate beneficiaries is to be placed on developers, the fulfilment of this obligation will need to be carefully monitored.
- The implementation of the IHP may be beyond the capacity of some, weaker municipalities.
- The burden of administering the IHP in respect of small projects may be too high.
- More work needs to be done to align the NDoH's IHP with existing initiatives at the provincial and local level.
- The IHP may impact negatively on smaller housing developers, as these developers will be less likely to absorb the costs attendant on complying with the

policy. Since many of the smaller housing developers are likely to be BEE firms, the matching of incentives to the burdens imposed is critical.

Many of these points were factored into the cost-benefit analysis conducted during the RIA. The main findings of the Inclusionary Housing RIA were:

- Provided that the incentives to developers match the burdens imposed, the benefit:cost ratio of the inclusionary housing policy, whichever option is used, remains constant at about 1.06 (i.e. the benefits marginally outweigh the costs in economic terms before factoring in the non-quantifiable social benefits of the policy).
- However, as soon as the incentives to developers fall below 90% of compliance costs, the benefit:cost ratio drops below 1, meaning that the policy will result in a net loss to society in economic terms, before factoring in non-quantifiable social benefits.
- It appears that the VPADD option will be more likely than the CIS option to result in a matching of incentives to compliance costs, in which case the VPADD option would be preferable.
- Where municipalities are weak, the implementation of the VPADD option will require significant spending on improved administration, which may reduce the attractiveness of the VPADD option in economic terms.
- On balance, the CIS option would appear to be preferable where municipal capacity is weak, and the VPADD option preferable where municipal capacity is strong.
- The implementation of the two dimensions of the policy should be phased in and closely monitored in order to gather better information on the conditions under which CIS outperforms VPADD and vice versa.
- The 'no-new-regulation' option is unlikely to achieve the objectives of the IHP and may be disregarded.

6.2 Access to Affordable Land for Housing Policy

The consultation process in respect of the Access to Land for Affordable Housing Policy identified ten key issues that are discussed in more detail in Annexure A. In summary:

- The policy context in which the proposed creation of an HDA is being pursued is fluid and quite confused. A thorough legislative review may be necessary before proceeding with this option.
- There is a risk that the HDA will be perceived as over-riding the constitutional mandate of provinces and municipalities in respect of housing delivery.

- The business case for the creation of an HDA should be more strongly developed. In particular, the ability of the HDA to undertake the work of underperforming municipalities better or more efficiently needs to be convincingly argued. Several respondents argued that, if the HDA option is pursued, municipalities that are already performing their housing delivery functions well should be exempted from the process.
- There is a need for further consultation between the NDoH and provincial and municipal government on the implementation of the HDA option. If implemented, such consultation may assist in ensuring that the HDA coordinates the work of all three spheres of government in respect of housing delivery.
- There is a need for improved coordination between the NDoH and other departments affected by the HDA proposal, especially the Department of Land Affairs (DLA).
- If implemented, the NDoH's HDA proposal will need to be kept clearly distinct from DLA's SPV proposal.
- The funding stream for the HDA proposal still needs to be clarified. It was suggested that NDoH and DLA should work together to develop a financial model that addresses how land for affordable housing will be acquired.
- The proposed HDA's capacity to deal with land acquisition on a large scale has yet to be addressed.
- There is a risk that the HDA will compete with the private sector in respect of the delivery of housing.
- The HDA could play a useful role in monitoring 'land performance' in cooperation with municipalities.

The main findings of the Access to Affordable Land for Housing RIA were:

- The success in economic terms of the HDA option is highly dependent on the correctness of the assumption that it will result in reduced transport costs for beneficiaries.
- The economic break-even point for the HDA option is -2.5km, i.e. if the policy results in beneficiaries having to travel 2.5km further to work than they otherwise would have, the implementation costs of this option will exactly match the benefits to the private sector in the form of reduced land costs.
- Any cost to the fiscus at this point will need to be justified in political terms according to the perceived social benefits of the policy.
- In order properly to assess the likely costs and benefits of subsidising the acquisition of well-located land for affordable housing, better information on average land values needs to be obtained. Such information will assist in calculating the average land loss figure, i.e. the difference between the market

price of the land acquired by the HDA or participating municipalities and the price at which it needs to be released to the private sector for purposes of affordable housing.

- The ABSA residential property market database may be a useful source of information for this purpose.

7. Conclusion

Neither the Inclusionary Housing RIA nor the Access to Affordable Land for Housing RIA indicates any specific benefits for poorer households. This is to be expected, since both policies are targeted at a beneficiary class situated somewhere between the low-income majority of South Africa's population and the middle class. In addition, since both policies are tied to influencing existing private sector housing development, neither promises to deliver housing at scale. Rather, these two policies must be seen as niche policies aimed at harnessing some of the skills, capital and energy associated with the private sector housing market in order to increase the supply of affordable housing. In the case of the Inclusionary Housing Policy, the expectation is that this will occur by incentivising or compelling private sector developers to include affordable units as part of larger housing development projects. In the case of the Access to Affordable Land for Housing Policy, the expectation is that this will occur through subsidising the acquisition of well-located land.

The two RIAs conducted for this project indicate that it is possible for the NDoH to achieve these goals at a net economic benefit to society, in addition to whatever social benefits may accrue. For this to occur, however, certain assumptions need to be borne out in practice. These include, in the case of the IHP, the state's capacity to match compliance costs to private sector developers with appropriate incentives, with particular implications for the municipal level, where the policy will be implemented. In the case of the Access to Land for Affordable Housing Policy, the state must be willing to subsidise the cost of acquiring well-located land, and have the capacity to pass these subsidies on to housing beneficiaries.

Annexure A: Consultation Reports

1. Inclusionary Housing Policy

The following report provides a brief review of the findings of the consultation process undertaken to inform an RIA on the development of proposals for inclusionary housing. A list of respondents is included at the end of the report.

Overview

On the whole, the external stakeholders with whom we spoke supported the concept of inclusionary housing, and felt that the model could contribute to improving social cohesion in South African cities. The notion that people who work in a particular area should be able to live in that area was broadly supported.

It was recognised that inclusionary housing policy is less about large scale delivery of affordable housing and more about addressing South Africa's race- and class-segregated built environment.

There were however a number of concerns about the economic feasibility of the proposal, the impact on the property market, the scale of delivery, and the capacity of local government to ensure its successful implementation. The need to work closely with representative organisations such as SAPOA (South African Property Owners Association), as well as with developers, was strongly underlined. It was also noted that policies of this sort should be formulated in consultation with representatives of the potential beneficiaries in order to ensure that supply is matched with need.

The benefits of the policy are clearly understood in terms of the potential to:

- Improve urban integration
- Bring people closer to areas where infrastructure is more available
- Disperse affordable housing units throughout communities to avoid pockets of low income units
- Mobilise the private sector in delivery of affordable housing

However, respondents also highlighted a number of risks, including:

- Failure of the intervention to address the housing backlog, given the large numbers of people who cannot access affordable housing options
- Placing people in communities in which they can't afford to live/can't access affordable social infrastructure such as schools, clinics, supermarkets etc
- Failure to build in sufficient flexibility in recognition of varying local circumstances

- Failure to target effectively
- Weak administration by poorly capacitated municipalities
- Administrative burden associated with monitoring many small developments (particularly since there are few large parcels of well-located land)
- A preference on the part of municipalities to sell land for the highest attainable price, pricing affordable housing options out of the market, and possible resistance from municipalities to application of reduced rates and taxes for affordable housing when located in expensive areas
- Increase in house prices overall

Key points raised by the respondents are discussed in more detail below.

1.1 Addressing the housing backlog

Respondents recognised that it would be difficult to predict how many affordable houses might be built under the inclusionary housing policy, given the wide range of variables which impact on the property market. The general perception was that the scale of delivery would be fairly small, however, while the impact on the industry would be significant. Respondents accordingly raised questions about the balance of costs and benefits associated with the intervention.

Nonetheless, a number of respondents, while acknowledging that the impact of inclusionary housing in terms of the broader housing backlog will be small, emphasised that the value of the proposal is in demonstrating the existence of a market for housing in this price-band, and, crucially, in achieving more integrated human settlements that have potential to influence inter-class relations over time.

It was however noted that the benefit of the policy would tend to be realised primarily by the first purchaser of a particular unit – with little assurance of continued affordability. The first purchaser of an affordable unit in an area of high-cost housing would clearly benefit from appreciation of the value of the property over time. This first owner would probably be able to sell for a considerable profit – rendering the housing stock less affordable for subsequent potential buyers. It was recognised that this could be controlled to some extent by 'preservation policies' and restrictions on future rental or sale of affordable units, but the extent to which prices are likely to increase over time is nonetheless likely to be significant.

There was a suggestion that the proposal to exempt developments where the average price is R1 million or more could be problematic. It was suggested that a feasibility analysis should be undertaken to determine how many houses are built, on average, in the exempted price range, compared to houses between R500 000 and R1 million, in order to understand the proportion of developments that would have inclusionary housing on site.

1.2 Placing people in communities in which they can't afford to live

The risk of locating affordable housing in suburbs with limited access to social infrastructure is potentially problematic. Respondents noted that while inclusionary housing has the potential to reduce transport costs for individuals by locating them close to their place of work, it may also inadvertently place them at a large distance from affordable schools, clinics and shops. This could result in potential transport-to-work savings being negated by transport-to-facilities costs. Respondents therefore emphasised the need to ensure that lower income households would be provided with reasonable access to necessary infrastructure. Respondents noted that the issue could potentially be addressed at least to some extent through establishment of affordable public transport options such as appropriate bus routes.

1.3 Need for flexibility in recognition of varying local circumstances

A developer currently involved in an inclusionary housing development noted that the process of arriving at a feasible project proposal was one of extended negotiation with the local council, to arrive at an arrangement that would be economically viable for the developer and would also meet the council's objectives. It was noted that the process clearly demonstrated the potential risks of developing a policy without working closely with developers.

Most respondents felt that if inclusionary housing is to become a mandatory requirement, the policy needs to provide broad parameters and guidelines at national level, with flexibility at local level to enable councils and developers to work together to come up with workable approaches in particular areas. Several respondents argued that while regulations and process with which developers must engage on a local level should be predictable and fairly uniform, flexibility would be needed in working out the detail of individual projects to ensure viability.

The view of most respondents was that the National Housing Department should engage with local councils according to their capacity to deliver different options for implementation. In councils assessed as lacking sufficient capacity to deliver, the National Department should implement more narrowly defined parameters and facilitate concentrated capacity building.

The need to encourage creativity in the application of the policy at local level was noted - encouraging local government, developers and communities to work together to identify good investments in particular neighbourhoods, and to develop projects that yield mutual benefits.

1.4 Appropriate targeting

The need to thicken and diversify the housing market was noted, particularly given the gap in the market for houses valued between R250 000 and R700 000. Respondents however raised concerns about the potential for misadministration at the point of sale.

The perception among respondents is that the need to ensure that the affordable housing in inclusionary developments is sold to appropriate buyers will be largely the responsibility of developers. Developers will need to filter the beneficiaries, based on their income and their ability to demonstrate that they work in the area. It is understood that the developer will apply for a subsidy from the government on behalf of the beneficiary, and that the additional funding will be provided by the banks as per their agreement with the Housing Department to assist in providing financing for affordable housing. Developers noted that, if this perception is accurate, the process will create additional administrative costs for them.

It was suggested that the possibility of corruption or weak administration could see the allocation of affordable housing in integrated developments to individuals who are not the beneficiaries envisaged by the policy. It was suggested that mechanisms could be found to help the market self-exclude people not within the target market, including restrictions on the title deed, requirements that buyers live in the property themselves rather than rent it out, and/or restrictions on structural amendments or additions to the relevant units, for example.

1.5 Weak administration by poorly capacitated municipalities

A number of respondents expressed reservations about the capacity of local government to manage the process effectively.

The view from developers is that the process of getting building approvals is currently fraught with delays, pushing up holding costs and creating blockages in the system for up to 4 years. Recent research shows that the process of moving from land to stand can take 36 to 49 months, with delays largely the result of management inefficiencies at local government level. It was suggested that several developers would cite high holding costs as a factor rendering affordable housing unviable option for private developers.

Respondents also emphasised the need for national government to positively support the process at local level, monitoring implementation and emphasising the provision of good quality affordable housing rather than cheap housing.

The need for effective audit of compliance with inclusionary housing requirements, with reference to prices charged by developers and incomes of purchasers, was emphasised by some respondents – together with the concern that municipalities would be unlikely to have capacity to perform such audits.

1.6 Administrative burden associated with small developments

Respondents noted that, if sub-divisions and small developments have to comply with inclusionary requirements, City Councils could be faced with an enormous administrative burden, particularly in rental cases since they will need to interact with multiple body corporates in managing their rental stock.

1.7 Municipalities' willingness to engage

The need to ensure that there is policy alignment and cooperation across the three tiers of government was stressed. Respondents noted that, for the policy to work effectively, officials at all tiers of government would need to champion its objectives and prioritise provision of infrastructure and services for these developments.

Respondents cited a number of examples of provincial and city level initiatives in the area of inclusionary housing. Gauteng and the Western Cape for example have formulated draft policies and are beginning to implement them, the City of Johannesburg has formulated a policy framework, and an inclusionary housing development is currently underway in Fairlands, Johannesburg. Some respondents suggested that the lack of engagement between the national policy making process and provincial and local government, and lack of efforts to build synergy between emerging approaches, was a missed opportunity.

1.8 Impact on the market

Several respondents suggested that current experience indicates that the implementation of inclusionary housing is financially tight but feasible, if all partners in the project are willing to make marginal reductions to their profit margins. This includes subsidisation of the cost of land by the local council/government department, reduction of developers' profit margin, and reduction of professional fees and estate agent commission.

It was noted that there is a limit to the extent to which costs can be recovered through the sale of commercial units. Developers were very clear that the proposal would affect their profit margins. Respondents noted that while larger, well-established companies would be able to absorb the additional costs imposed on them by the scheme, emerging developers and smaller operators would not be able to do so. It was suggested that the impact on BEE firms could be a huge issue, and that, in this regard, it would be essential to ensure that projects are priced so that they remain feasible for smaller developers.

It was suggested that it could be possible to offset costs by lowering the price that developers must pay for land, in the case of government-owned land, but that in respect of private land the policy would pose a huge challenge. In such cases, it was suggested that the government should provide a subsidy toward the costs involved in developing the 30% affordable housing.

It was also noted that the current delays and effort associated with acquiring government land for development or accessing government subsidies would need to be convincingly addressed to make such initiatives worthwhile for developers.

It was suggested that it would make sense to introduce the policy on a voluntary basis, with incentives, and to make it mandatory after a period of time. The view was that developers would be more willing to take risks and absorb costs if the process is incentive based.

Any retrospective application of the proposal would be strongly contested by developers, since this would negatively impact on developments already underway, that were conceptualised and costed according to a different policy environment.

Some of the incentives identified by respondents included as likely to make inclusionary housing a viable venture included:

- Cheap access to municipal-owned land for development
- Removal of current stumbling blocks and delays that arise as a result of incapacity in municipalities
- Speeding up of the process for approval of building plans and Environmental Impact Assessments (EIAs)
- Densification allowances with flexibility to produce lower-cost housing types alongside traditional single family homes[1]
- Tax incentives
- Expediting zoning requirements and permits
- Reductions in developers' contribution to local councils in respect of the affordable housing
- National government subsidies for provision of bulk infrastructure (municipalities, reportedly, often report a lack of funds for infrastructure services).

For the most part, respondents stated that, over time, if inclusionary housing as delivered on the ground is perceived as a high-quality, low risk option, the situation will normalise and the market will absorb the costs. The need for government to undertake an effective marketing and communication drive at an early stage, to address misconceptions and clarify requirements, was strongly expressed.

[1] One respondent suggested that densification incentives would be resisted by local communities who would refer to local Integrated Development Plans to contest densification

2. Creation of a Housing Development Agency

The following report provides a brief review of the findings of the consultation process undertaken to inform an RIA of the Housing Development Agency proposal. A list of respondents is included at the end of the report.

2.1 Policy Context

Both private sector and departmental respondents noted that the policy and legislation governing development of affordable housing is not very clear, and that existing mechanisms, such as the Development Facilitation Act, are not being properly used, particularly at provincial and local level.

Several external respondents emphasised the need for a comprehensive legislative review that looks at all legislation with an impact on housing, identifies the bottle-necks and problems, and looks at how existing mechanisms and policies can be used more effectively. Respondents also noted the need for policy alignment across the tiers of government, to ensure that processes are predictable and clear.

The need to look at innovative solutions, that go beyond Greenfield developments and address the housing backlog more broadly, including upgrading of informal settlements, was emphasised by a number of respondents.

2.2 Capacity at local level

The shortfall in capacity at local level was widely recognised, although it was noted that some municipalities are engaged in interesting initiatives. The perception is that many municipalities lack the capacity to work effectively with developers. Municipalities are also perceived as being constrained by the inefficiencies in the municipal finance act. Some respondents felt that many municipalities remain locked into 'RDP-style' thinking and are unwilling to explore innovative approaches to affordable housing delivery or to work with communities to identify sustainable approaches.

Despite capacity problems at local level, there is a risk that the Housing Development Agency will be perceived as over-riding the constitutional mandate of provinces and municipalities in respect of housing delivery. Government policy clearly states that local government is the platform for service delivery. All national departments are required to formulate master plans to demonstrate how they will capacitate local government in executing their mandate.

Representatives from National Treasury expressed concern that the proposal for an HDA risks a departure from this responsibility, since rather than building capacity at local level, the HDA will take over certain functions in under-capacitated municipalities. From Treasury's point of view this is not a long-term solution.

A public sector representative suggested that most municipalities currently do not have the capacity to run large scale projects. The HDA would therefore compliment existing initiatives without interfering in provincial and municipal functions.

A respondent informed us that the Parliamentary Portfolio Committee has recommended that the Department of Housing conduct an "accreditation process." Competent municipalities which do have operational housing programmes should be accredited and allowed to continue their programmes without HDA involvement, while municipalities who are unable to acquire accreditation should be assisted by the HDA.

2.3 The agency model

Representatives from National Treasury argue that government policy aims to devolve functions to local level, and that this is not addressed by establishing agencies. Treasury acknowledged that if the agency is appropriately structured and mandated, it has potential to be ground-breaking and to apply in other areas where functions are devolved to the local level. They however had serious concerns about the extent to which the HDA as proposed could potentially cut across the mandate of provincial and local government, potentially undermining constitutional provisions. They also raised concerns about the scope for duplication, and stated that the agency model must ensure that capacity is provided *where needed* without duplicating provincial functions.

Respondents noted that the new State Controlled Institutions Bill, when complete, will guide a review of all public entities. Entities will need to demonstrate and justify their purpose and function. The bill aims to ensure that form follows function i.e. the roles and tasks of an entity inform its structure and governance arrangements. Included in the Bill is a general agency model which aims to ensure appropriate governance arrangements and minimise cumbersome structures. Respondents from National Treasury noted that they have urged the Housing Department to align as closely as possible with the new legislation.

Given Treasury's concerns regarding under-performing government agencies, it will be important that any proposal to establish an agency is accompanied by a strong business case and a clearly costed proposal, which demonstrates the costs and benefits of the model, together with a clear rationale for the approach. In the case of the HDA, the business plan needs to clearly demonstrate what the HDA will do that municipalities are unable to do, within the context of the roles and functions of different spheres of government as defined in the constitution.

2.4 Coordination across tiers

Respondents suggested that that there has been limited consultation between the Department of Housing and provincial and municipal government regarding the

development of the HDA. There appears to have been limited if any discussion with provinces, several of which are currently developing their own policies and initiatives which could potentially have informed, and been informed by, the process at national level. Respondents noted that the need for coordination across the tiers of government is crucial in order to develop a workable and accurately costed implementation plan for the HDA.

It was suggested that the HDA could be an important tool in improving coordination across the different tiers of government, which are perceived as not talking to each other at present. A developer noted that while the provinces are pushing for housing development, municipalities respond that they are unable to release land and/or that funds for service infrastructure are unavailable. The respondent suggested that an HDA could potentially be a useful demonstration of political will, leaning on municipalities to make land available. It was emphasised that the HDA must have the authority and capacity to push projects through at provincial and local level.

2.5 Alignment with other Departments

During consultation the Department of Housing expressed a need to know more about the status and content of the Department of Land Affair's Land Use Management Bill. Housing is under the impression that the Bill aims to merge a number of different development bills, including relevant provincial ordinances, and this will have a bearing on National Housing policy.

The need for improved coordination among the relevant departments, particularly Housing and Land Affairs, was raised by a number of external respondents, and was acknowledged within the Departments concerned. The creation of an HDA was viewed by some respondents as a potential mechanism to improve departmental coordination, potentially brining more predictability to the process of moving from land acquisition to housing development.

One respondent suggested the need for a Housing Sector Plan which would align with other sector plans and ensure appropriate linkages with services such as transport and water, to inform the work of an HDA. The need for a clearer relationship between the DLA Special Development Framework and municipal level spatial development frameworks was also suggested.

There appears to be a risk that the perception of time pressure (partly owing to the need for Transnet to transfer its land) will encourage the Housing Department to attempt to rush proposal to completion. However, the Department acknowledges that while the relevant sector departments (DLA, DPLG, DPW, DPE) are aware of the proposal, the relationship with these departments has not been very collegial to date, and they are likely to raise resistance if the proposal is perceived as being rushed through without

proper consultation. Given the need for the agency to work cooperatively with other departments, it will be important to ensure alignment.

2.6 Role of Land Affairs

The Department of Land Affairs is currently developing a Special Purpose Vehicle to focus primarily on proactive land acquisition in rural areas. A DLA representative suggested that the SPV was being developed under the provisions of the Land Bank Act (as a subsidiary), and that it would be able to draw on funds from the Land Claims Commission, various agricultural programmes and the R1.5bn pledged by financial institutions to assist in agriculture reform under the financial services charter.

A DLA representative noted that his department was initially concerned that Housing's proposal would centralise delivery, and that it was not informed by the IDPs and sector plans, but that there has recently been some convergence in the principles underlying the proposals. Discussions about the feasibility of a super SPV which would incorporate both agriculturally focused SPV and HDA type functions have been shelved.

The Departments of Housing and Land Affairs have agreed that they will pursue parallel processes to enable each department to create an agency to address its own primary needs. Each department will be represented on the Boards of these agencies, but there will be a clear lead department in each case.

2.7 Funding arrangements

The Department of Housing acknowledged during consultation that the cost implications of the HDA are not yet clear. A Housing representative suggested that the HDA will need to be financed partially by government budget and will be partially self-financing, in that it will engage in business that generates income. This requires clarification.

The Department of Housing reported that the DLA would contribute approximately R250m toward the HDA. The Housing Department noted that this would be feasible since the DLA has under-spent on its current budget. The Department of Housing reported that the DLA had indicated a willingness to fund the acquisition of land. The Housing proposal is that an agency agreement will be concluded between the agency and DLA. Similarly agency agreements will be developed between the agency and provincial housing departments and municipalities.

National Treasury has however raised serious doubts about the workability of this proposal, and questions why DLA would place funds under the control of another department. Treasury has also expressed concerns that the current proposal lends itself to double or triple filing, creating a context in which Housing, DLA and possibly other departments could approach Treasury for funds for land acquisition.

A DLA representative reported that his department would not be placing their funds under the control of Housing. He noted that DLA has a mandate for land redistribution and that there is an expectation that the department will acquire land for housing development. DLA is prepared to acquire land and give that land to the Housing Department *if* the need for such land has been clearly identified and if all the other regulatory requirements are met. According to the DLA, the Department of Housing must identify the land, obtain all the necessary approvals, and then the DLA will send in a valuer and will buy the land at an appropriate price. The DLA will hold the land and make it available for development once the relevant processes have been successfully completed. The DLA can hold land in a Trust, but it will not transfer funds to municipalities or the Housing Department.

During consultation a Housing representative stated that the DLA and Housing have a written agreement that the DLA will provide a specific level of funding, and that DLA acknowledges that it is within its constitutional mandate in making money available for this purpose and does not require Treasury permission. A DLA respondent however reported that there is at present no formal agreement between Housing and DLA on the HDA. This needs to be clarified.

2.8 Capacity of the HDA

Several respondents raised questions regarding the proposed HDA's capacity to deal with land acquisition on a large scale, and large housing development projects, particularly if Thubelisha[2] is to be reconstituted as the HDA. Respondents noted the huge effort required for effective land administration, and raised questions about the extent to which a central HDA would be able to carry out this mandate.

It was noted that the HDA in itself would not solve the capacity issue – there would also need to be champions at each sphere of government, responsible for liaising with the HDA and ensuring implementation at local level.

2.9 Relationship with the private sector

There is a risk that the HDA proposals as currently conceived may conflict with the principles of the Comprehensive Plan, which aims to bring the public and private sectors together. The HDA may be perceived as competing directly with the private sector in the provision of housing, should it choose to act as a developer in its own right.

Representatives from National Treasury expressed concerns about the extent to which the agency would set itself up in competition with private sector developers. They noted that if government or parastatals sell state-owned land to the HDA at a subsidised cost,

[2] Thubelisha Homes was established for the purpose of procuring and developing housing stock appropriate for rightsizing purposes, financing relevant stock, evaluating clients, granting credit and selling houses to approved clients

it will be important to ensure that the market value of the land is not subsequently realised by the HDA, and that the saving must in all circumstances be realised by the affordable housing beneficiary.

It was noted that clarity is required as to whether the HDA will focus exclusively on affordable housing. The proportion of the HDA's operations that will be classified as business operations also requires clarification, as does the anticipated time period in which the HDA can be expected to achieve positive returns and reduce dependence on subsidies.

A number of respondents expressed concern that the extension of Thubelisha's mandate two years ago had enabled the agency to act as a developer, in competition with private sector developers. A Thubelisha representative acknowledged that the agency currently has limited interaction with the private sector on projects. Provinces provide funding, and Thubelisha administers the subsidies and sources the necessary engineers, town-planners and contractors.

Departmental representatives suggested that this is not a substantive issue, given that the mega-projects in which Thubelisha is engaged are funded from a number of different departments and that a private sector developer could not readily tap into these funds. Similarly, a private sector developer is unable to organise the bulk infrastructure needed for a new development, and is thus always contracted as the developing agent working under the municipality.

The response from small and medium development companies however is that Thubelisha competes directly with developers, and has the advantage of being subsidised by government. A respondent noted that this has caused major problems for smaller companies in the Eastern Cape, where Nafcoc is currently in discussions with Thubelisha on the 'unjustified expansion' of their mandate and would argue for the phasing out of Thubelisha on these grounds.

2.10 Adding value

One respondent suggested that the HDA could usefully take on the role of considering 'land performance' – looking at land strategically and considering the most effective use for the land from various perspectives. It was suggested that if the HDA could develop a database of detailed information about each piece of land, including for example the municipality's preferred development choice, it could greatly enhance the planning and development process.

This proposal ties in with the DLA's focus on area based land reform, which aims to encourage municipalities to use their IDPs and sector plans to identify appropriate land uses.

2.11 Other issues

Questions were raised regarding the arrangements for 'disposing' of land, and what would happen to the residual.

The issue of 'holding' land requires clarification. The consultants have been informed that the current Cabinet Memo does not include a 'holding' function for the agency, given that holding costs are very expensive and that the Treasury has raised concerns about who will pay for holding costs. It has been suggested to the consultants that the agency would either hand the land back to municipalities for holding, or, in the case of acquired land, would match the land to programmes or projects.

3. Respondents included in consultation process

Housing Department:

Mr Richard Thatcher, Director: Legal Services
Mr Anton Arendse, Director, Human Settlement Policy
Ms Julie Bayat, Acting Chief Director: Monitoring and Evaluation
Mr Morris Mngomezulu, Director: Industry Analyst, Housing
Mr Thozamile Botha, Chief Special Advisor to the Minister
Professor Dan Smit, Advisor to the Minister

Department of Land Affairs

Mr Mdu Shabane, DDG: Land and Tenure Reform

Department of National Treasury

Mr Goolam Manack, Director: Public Entity Governance Unit: National Treasury
Ms Marissa Moore, Director: Transport and Housing

External Stakeholders

- Mr Jason Teasdale, Partners for Housing
- Mr Arron Cecil Steyn, DA MP
- Mr Anthony Forgey, Crowie Projects
- Mr Joe Pelser, Sable Homes
- Mr Gregory Mofokeng, Nafcoc Construction
- Mr Kribbs Moodley, SAPOA
- Mr Aubrey Manganye, Thubelisha Homes
- Ms Kecia Rust, Consultant
- Ms Sarah Charlton, Wits School of Architecture and Planning
- Mr Francois Viruly, School of Economics, Wits
- Professor Marie Huchzermeyer, Wits School Architecture and Planning
- Manye Moroka, CEO Thubelisha Homes

Annexure B: Reference Group Members

Mr Anton Arendse, Director, Human Settlement Policy, NDoH
Ms Julie Bayat, Acting Chief Director: Monitoring and Evaluation, NDoH
Mr Richard Thatcher, Director Legislative Drafting, NDoH
Mr Dan Smit, Special Advisor to the Minister of Housing
Mr Thozamile Botha, Special Adviser to the Minister of Housing
Mr Mdu Shabane, Deputy DG: Land and Tenure Reform, Department of Land Affairs
Ms Tlou Mathonzi, Chief Planner, Department of Land Affairs
Ms Marissa Moore, Director: Transport and Housing, National Treasury
Ms Louise Du Plessis, Regulatory and Sector Analysis, National Treasury
Pierre Venter, FSE Coordinating Housing Initiative, Banking Association
Tsakane Shilubane, Manager: Legal Services, SAPOA