Inclusionary Housing Bill

Initial Regulatory Impact Assessment

11 May 2007

PREPARED BY SBP

FOR

URBAN LANDMARK

working with the Department of Housing

Sub-contractors to SBP

Palmer Development Group
Theunis Roux

Glossary

BBBEE	Broad Based Black Economic Empowerment
CIS	Compulsory but incentive-synchronised
IHP	Inclusionary Housing Policy
NDoH	National Department of Housing
RDP	Reconstruction and Development Programme
RIA	Regulatory Impact Analysis
SAPOA	South African Property Owners' Association
VPADD	Voluntary pro-active deal-driven

1. Title of proposed measure

Inclusionary Housing Bill (to be introduced by the National Department of Housing).

2. Purpose and intended effect of measure

2.1 Background to the problem

The demand for affordable housing in South Africa exceeds supply. In 2005, the effective demand for housing units costing more than the current cost of a fully subsidized RDP house but less than R200 000 stood at 75 000, whereas only 16 000 units in this category were supplied per year by the market between 2000 and 2004. The main reason for this undersupply is the scarcity and high cost of well-located land. In other, less well-located, areas on the urban periphery, the non-availability of credit presents a significant barrier to access. The housing market in these areas is dysfunctional, meaning that home owners have not benefited from the sustained property market boom in middle- and upper-income residential areas.

Coupled with this, there is the problem of ongoing racial and class segregation in South Africa's cities. Although there has been some racial integration in the mid- to upper-end of the market, the pace of integration is slow and largely dependent on the deracialiastion of the South African economy. At the same time, residential areas are still geographically segregated by class, with the working class/poor living in low-income housing developments, former black townships or informal settlements on the urban periphery, and the middle- to upper-class living either in older residential areas close to the urban core or in self-contained housing developments on the outskirts of the city. Notwithstanding the success of some recent urban renewal projects, there is currently very little affordable housing for working class people close to their places of employment in the city centre.

Urban sprawl is closely associated with these two problems. Population densities in South African cities are very low by international standards, resulting in increased service and transport costs for those living on the urban periphery. Since the poor are mostly concentrated in these areas, they are the worst affected.

Government is currently pursuing several initiatives to try to remedy these problems. Apart from urban renewal projects, the National Department of Housing's social housing programme is aimed at increasing the supply of affordable rental housing units close to the urban core. Many municipalities are relaxing their zoning regulations so as to promote the densification of existing residential areas. However, none of these initiatives is specifically targeted at increasing the supply of affordable housing in existing middle- to upper-income residential areas.

2.2 The objective

The primary objective of the Inclusionary Housing Policy is to promote greater social inclusion/integration and to break with highly segregated processes of built environment creation in South Africa. Boosting the supply of affordable housing is a secondary objective. The bill also aims to mobilise private sector delivery capacity for the provision of affordable housing, leverage new housing opportunities off existing stock, promote densification, and make better use of existing infrastructure.

2.3 Definition of affordable housing

For purposes of this RIA, *affordable housing for ownership* is defined as housing priced between the top end of the RDP housing range, and the top end of the 'affordable housing range' defined in the Financial Services Charter plus 40%. Currently this implies a range of between R50 000 and R350 000.

*Affordable housing for renta*l falls in the range between the rent that someone earning R1500 a month can pay and the rent that someone earning R7500 per month plus 20% can pay. This implies a rental range of R600 to R3 000 per month.

3. Risk assessment

3.1 The risk in not regulating

Without state intervention, there is little prospect that market forces will change the spatial expression of race and class difference in South Africa. At best, other state interventions aimed at broadening access to the economy will result in changes to the racial composition of middle- to upper-income residential areas. However, these measures will have little or no impact on the spatial expression of class difference.

The relationships between social stratification by race and class, on the one hand, and crime and political instability, on the other, are complex. Whilst the IHP cannot on its own mitigate risk in this context, it can make a contribution to social cohesion by diversifying the residential housing sector, and in this way promoting social interaction and opportunities for some mobility across the race and class divide.

3.2 Risks in regulating

The IHP could slow down the rate of production of new private sector housing

There is a risk that the introduction of the IHP will slow down the rate of production of new private sector housing without achieving its affordable housing and social integration targets. Research commissioned by the NDoH shows that inclusionary housing programmes are not that common in developing countries because of the small size of the private sector property development market in such countries, and the high disparity between the rich and poor. In South Africa, developers have been seen to move out of the market for subsidised housing and could potentially react in a similar manner if the Bill fails to demonstrate the intended ‘win-win’ approach.

International experience suggests that this risk is correlated to the flexibility of the policy mechanisms used: the more inflexible the policy mechanisms, the higher the risk that the Bill will reduce the rate of production of new housing units. Contextual realities at local level must be central to considerations regarding the design of inclusionary housing schemes. In addition, there is evidence that the provision of suitable incentives to housing developers can significantly mitigate the risk of unintended consequences.

Municipalities will not have capacity to drive effective inclusionary policies at local level

There is considerable risk that municipalities do not have appropriate capacity to drive effective inclusionary policies at local level, or to effect the types of incentives that would make such projects feasible for developers. Consultation suggests that many municipalities do not have appropriate in-house town planning and negotiation skills to engage effectively with developers, and may have to look to outside consultants to assist them in this regard. This would clearly result in increased professional fees associated with such developments.

Mismatch between existing infrastructure and the requirements of densification

The inclusionary housing policy relies heavily on densification as a mechanism to offset the costs of affordable units. There is a risk at municipal level that the mismatch between existing infrastructure and the requirements of densification will effectively provide an easy opt-out option for developers.

Related to this is the risk that municipalities will have inadequate funding to carry out necessary bulk infrastructure upgrades, further limiting densification potential.

Fast-track planning/rezoning approvals as an incentive for inclusionary schemes

The expectation that municipalities will fast-track planning/rezoning approvals as an incentive for inclusionary schemes assumes that capacity is available at municipal level to significantly speed up existing processes. Municipalities are likely to need to employ additional, skilled staff to give effect to this improved efficiency. The alternative, that permissions for other developments are forced to the bottom of the pile in order to prioritise inclusionary housing, is highly problematic in the context of the broader market. There is considerable risk that incentives for IHP projects will not be realised as a result of inadequate capacity, resulting in such projects being regarded as unfeasible by developers.

Variations in the extent to which the beneficiaries will actually work in the local area and benefit

The cost-benefit assessment quantifies the economic benefits of inclusionary housing in respect of decreased transport costs, as a result of housing being located closer to employment opportunities. However, it should be noted that the matching of housing beneficiaries with local employment opportunities is difficult at the outset and is particularly difficult to maintain over time. There is a risk that the extent to which the beneficiaries of inclusionary housing will actually work in the area and benefit from reduced transport costs will be extremely variable, particularly since individuals are very likely to change jobs over time. This risk could be mitigated to some extent through the availability of affordable rental stock, which gives beneficiaries more flexibility and mobility than ownership. However, while both rental and ownership options address the social benefits of more integrated and compact cities, the rental option fails to achieve the wealth creation objective of the Comprehensive Plan.

Insufficient research and social assessments prior to land purchase

There is also the risk of presuming that certain land is 'well located' without sufficient research and social assessments prior to land purchase. The availability of appropriate social infrastructure, including public transport links, must be taken into account in order to adequately realise the social and economic benefits of improved integration.

4. Options

The NDoH is currently considering a proposal that combines a Voluntary Pro-active Deal-driven (VPADD) component together with a Compulsory but Incentive-synchronised (CIS) component. For the purposes of the RIA, these components are analysed separately, together with a third, 'no -new-regulation' option.

- **Option 1: Compulsory but incentive-synchronised approach (CIS).**
- **Option 2: Voluntary pro-active deal-driven approach (VPADD).**
- **Option 3: No new regulation approach.**

Each of these options is now described in more detail.

Option 1: Compulsory but incentive-synchronised approach (CIS)

This option aims to ensure that mandatory requirements are offset as far as possible by appropriate incentives. The IHP will set national parameters for the building of affordable houses by the private sector, and outline a number of different inclusionary housing models from which municipalities can choose. The policy will specify certain incentives that municipalities can employ which apply countrywide to all housing developments falling within its ambit (for example, tax incentives, social housing subsidies and credit-linked subsidies), whilst allowing municipalities to create other incentives applicable to developments within their area of jurisdiction (zoning concessions, expedited development approval procedures and density bonuses). The CIS will be driven and implemented by municipalities. Development permissions would be made contingent on meeting specified inclusionary housing requirements defined at local level.

The emphasis in this option is on flexibility, with a sliding scale minimum percentage of affordable units depending on the nature of the housing development and the total package of incentives provided. Municipalities will be encouraged to use their various planning tools creatively in pursuit of inclusionary outcomes. Where, for example, the housing development occurs in an area that is not suitable for densification (for example, because of poor transport infrastructure) the municipality's inability to provide developers with a density bonus will be off-set by reducing the percentage of affordable housing units required.

Where the average unit price in the development is more than three times the upper limit of the affordable housing range, developers will be permitted to meet the stipulated minimum affordable housing percentage by building affordable housing units in other developments. Alternatively, where the average unit price exceeds by three times the upper end of the affordable housing range, developers can choose to pay a nationally set levy. Levies paid in this way will be transferred directly to the relevant municipality and will be part of general revenues, with the intention of incentivizing other inclusionary housing projects in the municipal area concerned.

The precise mix of incentives and the percentage of affordable housing units built will be agreed on a project-by-project basis between the developer and the municipality concerned. Municipalities will, however, set an absolute minimum percentage for specific areas within their jurisdiction, below which no project may fall. The maximum proportion of affordable housing units in any one development will be 60%.

The role of provincial government in terms of this option will be to set provincial targets and parameters, provide subsidies, build local government capacity and monitor provincial progress.

Inclusionary housing units may only be sold within the first ten years at the original price paid, escalated for building inflation. Where units are rented out, rent increases will be restricted for ten years to the original rental escalated by the CPIX. The cost of maintaining affordable housing units will be borne by the owners and landlords concerned.

Option 2: Voluntary Pro-Active Deal Driven approach (VPADD)

Under this option, the IHP will not prescribe minimum or maximum percentages for affordable housing, but will set out the range of permissible incentives that can be used by government at all levels and empower government departments to set non-mandatory goals for inclusionary housing in new projects.

The role of local government in terms of this option is to make available land for new housing developments, and to proactively enter into market-related deals with the private sector for the development of inclusionary housing, driven by guarantees of quick development application processing times. These deals will include provision for a substantial portion of units to be affordable stock (dependent on the extent of incentives available and various external factors). Private sector partners will also be encouraged to approach municipalities with project proposals.

Both national and provincial governments can become directly involved in proactively pursuing partnerships with the private sector, usually with the inclusion of municipalities.

Approach 3: No new regulation

As noted above, the government is already pursuing several initiatives to try to improve the supply of affordable housing, including a number of urban renewal projects, the national social housing programme, and various densification schemes and voluntary inclusionary housing projects at municipal level.

Under the ‘no new regulation’ approach, the government has the option of continuing along these lines and possibly increasing the incentives available for inclusionary housing projects entered into on a voluntary basis, without introducing any new regulation. However, it is unlikely that this approach would see a significant increase in the supply of affordable housing in middle- to upper-income residential areas. As noted above, without state intervention there is little prospect that market forces will change the spatial expression of race and class difference in South Africa.

5. Cost Benefit Analysis

The costs and benefits of the proposed inclusionary housing requirement are dependent on a number of policy decisions and on the likely scale of the response to the new policy. A simple model has been established for the purposes of evaluating these costs and benefits. The model allows some of the key policy variables to be altered, including the various threshold property values in the policy and the percentage of units to be dedicated to social housing. Other assumptions of the model, such as rates of return on different property types, are also adjustable.

A single model is used to analyse the regulatory options. Key components in the model are adjusted to take account of the different benefit-cost implications of the regulatory options.

Sectors affected

The IHP is a national policy affecting all new housing developments of a specified scale and value. The starting point for the analysis is therefore an assessment of the current level of supply and the frequency distribution of supply (the percentage supply of housing units of different value). It was presumed that for the first year the 2005 level of supply of all housing would be maintained, equivalent to about 68 000 units[1]. This value can be adjusted.

The table below indicates the number of market units (where a market unit is a conventional unit sold onto the market) that would have been provided according to current levels of supply and, in the second row, the number of market units provided with the IHP in place. The number of additional affordable units provided as a result of the policy is shown in the third row.

Market related units that would be provided without IHP	30 523
Market related units provided under the Inclusionary Housing Policy	21 367
Additional affordable units provided under the Inclusionary Housing Policy	9 156
Affordable units to be provided off-site	1 212
% of units in developments below cut-off value that will be affordable	33%

The final two rows of the table show the number of affordable units that have to be provided in other developments. This serves as a check on the feasibility of the cut-off values used.

It is important to note that this analysis assumes that developers will decrease their supply of market units due to some of these being displaced by the need to provide affordable units. However, it is possible that the overall level of supply will increase to match existing demand for market units. This is an empirical question that requires further research and modelling as it depends on such factors as supply capacity in

[1] Matthew Nell and Associates, 2005; *Research into Housing Supply and Functioning Markets*, various reports, Banking Association of South Africa, Housing Workstream Group.

the industry. Anecdotal evidence from discussions with developers suggests that either scenario could occur.

Cost categories

The IHP has both implementation and compliance costs.

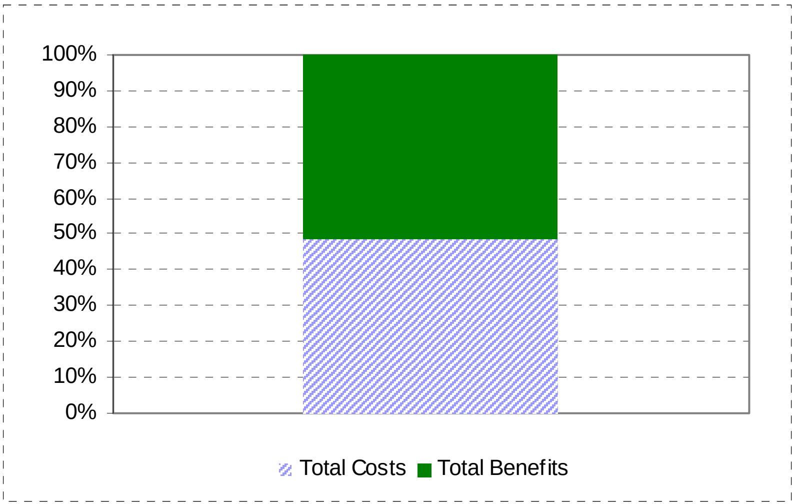
The implementation costs are due to losses of property rates by municipalities, rather than additional administrative burdens. It is likely that there will be some additional administrative costs but these have not been quantified at this stage.

The major compliance costs of the policy relate primarily to the losses in profit margins of developers due to the (probable) decrease in the number of higher value units developed and sold.

5.2 Comparative Cost of Options

5.2.1 Option 1: Compulsory but incentive-synchronised approach (CIS)

Option 1 has been assessed using the draft policy prescriptions of a 30% inclusionary requirement, a maximum value of R350 000 deemed to be affordable and a threshold of three times the maximum value for those developments allowed to locate affordable units off-site. A summary of the costs and benefits emerging from the CIS approach is shown in the figure below.



The net result is a benefit-cost ratio of 1.06 which indicates that the benefits outweigh the costs of the policy under the modelling assumptions. The costs and benefits considered are discussed below.

Implementation Costs

The only quantifiable implementation cost within the scope of this RIA arising from introduction of the policy is the loss of property rates revenues to municipalities. This loss of revenue occurs because it is assumed that developers replace higher value units with affordable units, and the total value of units built thus declines. The property rates loss is an ongoing loss each year.

A property rate of 1.18 cents in the Rand has been assumed, with no rates levied on the first R50 000 property value. The net present value of the total implementation costs due to the loss of property rates revenue is R261 million (arising from a R32.5 million loss per annum).

It is possible, as discussed above, that the market response will be to increase the overall supply and hence maintain the supply of market related units. If this is the case then the property rates losses will not occur.

Administration costs

It has not been possible to adequately quantify the costs of administering the CIS IHP approach. However, the costs are likely to be significant and should be borne in mind when evaluating the costs and benefits of the policy.

Compliance costs

The costs of compliance can be reduced to the profit loss suffered by developers. Compliance costs due to decreased profit margins have been calculated based on presumed differences in profit margins between lower value affordable units and the higher value market related units. The difference in profit margin is the main driver of the costs of the policy – if there were no difference in profit margin there would be few disincentives for developers to build affordable units.

It is very difficult to get sound data on profit margins in the industry. Anecdotal evidence based on discussions with developers suggests that profit margins could be negative in certain circumstances (for example, under onerous municipal requirements for the affordable housing stock) but could rise to bankable levels if the affordable units were well developed and sold on the open market.

An assumed set of profit margins is used in the model. These are all adjustable. For the purpose of modelling, the profit margin on affordable units was assumed to be 8%. Profit margins were assumed to rise to 20% for higher value properties. On the basis of these initial assumptions the costs to developers is R585 million per annum. This is due to an *average* reduction in the profit margins of these developers from 16% to 14%.

The sensitivity of the final benefit-cost ratio to the assumptions around profit margin differentials is shown in the table below. In all cases, the profit margin on high value properties is assumed to be 20%.

Profit margin on affordable units	***0%***	***8%***	***20%***
Total compliance costs	R613 million	R585 million	R458 million
Benefit:cost: ratio	1.06	1.06	1.07

The total compliance costs are significantly affected by changes in the assumptions around profit margins. However, the final benefit-cost ratio is very *insensitive* to these changes in compliance costs. This is because it has been assumed that, under the CIS option, a package of incentives for developers will be put together in such a way that the benefits to developers exactly balance out the compliance costs that they incur. The degree to which incentives for developers match compliance costs is critically important to the eventual economic impact of the regulation. The greater the profit margins on affordable housing units diverge from those on high value units, the more important becomes the matching of incentives to compliance costs. See the section on benefits below for more detail.

The actual cost impacts are likely to be more nuanced, as responses are to be expected from developers by way of alterations in development approaches in an attempt to maximise returns.

5.2.2 Option 2: Voluntary Pro-Active Deal Driven approach (VPADD)

It is not possible to satisfactorily model the cost impacts of the deal-driven approach. The impacts of the approach rest significantly on how municipalities would respond to the new policy approach and the various local approaches which they would use.

The costs and benefit categories of the VPADD approach will be the same as those for the CIS approach. However, under this option:

- It is more likely that the incentive package offered to developers will compensate them for compliance costs, as incentive packages will be structured on a project-by-project basis.
- The costs of administering the policy are likely to be higher under the VPADD option, due to the need to structure each project differently. It has not been possible to quantify these costs,

5.2.3 Option 3: No new regulation

Implementation Costs

Option 3 incurs no new implementation or compliance costs.

6. Benefits

Option 1: Compulsory but incentive-synchronised approach (CIS)

Social benefits

The benefits of the inclusionary housing policy are largely social. These benefits, such as social cohesion, improved equity and economic and racial integration, are difficult if not impossible to quantify in monetary terms. The benefits that are quantifiable are those direct benefits that would accrue to property developers as concessions to offset their implementation costs.

Incentives received by developers

Under the CIS approach, it is envisioned that a package of incentives will be provided that will balance out the costs incurred by developers in complying with the policy. These incentives include tax benefits, easier access to land, fast-tracking of the approvals processes, receipt of development and land use rights, provision of bulk and link infrastructure and access to government housing subsidies. The exact form that incentives will take is still uncertain, and so it has not been possible to model the incentive package with any accuracy. It has been assumed that the total incentives offered to developers will have the same monetary value as the compliance costs that they incur.

It should be noted that the provision of some of the proposed incentives will result in implementation costs incurred by municipalities[2]. It has not been possible to model these implementation costs due to the high level of uncertainty around the nature of the incentive package.

The sensitivity analysis shows that the benefit-cost ratio of the CIS IHP is very sensitive to the extent to which the incentive package does in fact balance out the compliance costs, as shown in the table below.

Incentive package as % of compliance costs	***100%***	***90%***	***75%***
Benefit:cost ratio	1.06	0.99	0.89

If the incentive package does not fully compensate developers for compliance costs, the overall benefit-cost ratio of the policy rapidly falls below 1.

Reduction in travel distances

Although the primary aim of the IHP is to improve social cohesion by encouraging a better balance of race and class in new developments, the policy is also intended to bring low- and lower-middle income households closer to their places of work. If this is achieved, it will generate several significant benefits:

- *Reduction in transport costs to households*: Transport represents a significant cost to households. The magnitude of the reduction in transport costs depends on whether households use private cars, buses or taxis to travel.
- *Reduction in public transport subsidies allocated by government*: If the use of bus travel decreases due to shorter trip lengths, then the magnitude of public transport subsidies allocated by government will decrease.
- *Reduction in pollution costs*: Shorter journeys mean less petrol used, and thus less CO_2 and other pollutants generated.

The monetary magnitude of the benefits listed above depends largely on the extent to which trip lengths are in fact reduced as a result of the introduction of the policy.

In the analysis it has been assumed that all residents of the affordable units delivered under the policy have their average trip lengths reduced by 10km. The total benefit-cost ratio is very sensitive to the proportion of residents who in fact benefit from shorter trip times, as shown in the table below.

% of residents of new units that benefit from a 10km reduction in trip lengths	***100%***	***50%***	***0%***
Benefit:cost ratio	1.06	0.88	0.69

[2] For example, tax benefits are in fact neutral in economic terms. They represent a benefit to developers, but a cost to government, who loses tax revenue.

If units are allocated to people who do not work in the local area, the total benefits of the IHP will be significantly reduced. Note, however, that a requirement that units be allocated to people who can demonstrate that they work in the area will result in higher administration costs, since beneficiaries will have to go through a filtering process. It has not been possible to model the extent to which this higher cost will outweigh the benefits of shorter trip lengths.

Option 2: Voluntary Pro-Active Deal Driven approach (VPADD)

As indicated above, it is not possible to model the impacts of the deal-driven approach. The impacts of the approach will depend significantly on how municipalities respond to the new policy approach and the various local approaches which they might use.

However, it can be expected that under this option:

- It is more likely that the incentive package offered to developers will compensate them for compliance costs, because incentive packages will be structured on a project-by-project basis.
- The administration costs (which it has not been possible to quantify) are likely to be higher under the VPADD option, because of the need to structure each project differently.

Option 3: No new regulation

Option 3 has no quantifiable benefits, since the approach relies on existing regulatory and incentive-driven mechanisms.

7. Summary of Costs and Benefits

The economic modelling shows the costs and benefits resulting from the introduction of an IHP using the CIS approach to be approximately equal.

The following comments should be borne in mind when interpreting this result:

- It has not been possible to model the benefits of improved social cohesion that result from the introduction of this policy. These benefits are likely to be significant.
- It has not been possible to model the costs of administering the policy. These are likely to be significant, particularly if attempts are made to allocate the affordable housing units to beneficiaries who work in the area. Similarly, structuring and managing incentive packages for developers involved in inclusionary housing projects will incur significant administration costs.

Key factors that impact on the costs and benefits of the CIS IHP option are:

- The extent to which an incentive package that fully compensates developers for the costs of complying with the policy can be structured and effectively administered. If developers are not compensated sufficiently, the benefits of the policy will be significantly reduced. In addition, developers may pass higher costs on to buyers, or the number of developments may decrease.

- The extent to which travel distances are in fact reduced due to the policy. If reductions in travel distances are not realised, the benefits of the policy will be significantly reduced.

For Option 2, the deal-driven approach, it has not been possible to model the costs and benefits since the impacts of the approach rest significantly on how municipalities respond to the new policy approach. However, it can be expected that under this option

- It is more likely that the incentive package offered to developers will compensate them for compliance costs, as incentive packages will be structured on a project-by-project basis.
- The costs of administering the policy, which it has not been possible to quantify, are likely to be higher under the VPADD option, due to the need to structure each project differently.
- The overall impact of the regulation will be smaller as some municipalities will simply not respond to the new regulation due to capacity constraints.

8. Comparative Assessment of Regulatory Options

Criterion	*Option 1*	*Option 2*	*Option 3*
Economic growth and development			
Growth impacts	Limited to moderate impacts. May be negative on the construction industry if there is a net reduction in higher-income units built.	Limited impacts. Likely to be lesser than in Option 1 as deals will lead to closer balance between costs and benefits of compliance.	Business as usual growth pathway.
Competition implications	None.	None.	None.
Small business implications	Larger firms may be more able to easily respond to new IHP requirements and gain market share. However, there are indications that innovative small firms could benefit similarly.	Larger firms may be more able to easily respond to new IHP requirements and gain market share. However, there are indications that innovative small firms could benefit similarly.	No impacts.
BBBEE impacts	Should not have any impacts on industry ownership structure.	Should not have any impacts on industry ownership structure.	No impacts.
Employment			

Criterion	*Option 1*	*Option 2*	*Option 3*
Job creation	Limited to moderate impacts. May be negative on the construction industry if there is a net reduction in higher-income units built.	Limited impacts. Likely to be lesser than in Option 1 as deals will lead to closer balance between costs and benefits of compliance.	Business as usual growth pathway.
Distribution & equity			
Poverty reduction	Limited positive impacts on poorest households as beneficiaries are likely to be in the ‘affordable housing’ income brackets. Some increased delivery of social housing allowing new entrants into the market by creating space at the lower end of the housing market.	Limited positive impacts on poorest households as beneficiaries are likely to be in the ‘affordable housing’ income brackets. Some increased delivery of social housing allowing new entrants into the market by creating space at the lower end of the housing market.	No impacts.
Income distribution	Will improve income distribution – especially if more social housing units are made available. Will create new assets for beneficiaries of well-located affordable units.	Will improve income distribution – especially if more social housing units are made available. Will create new assets for beneficiaries of well-located affordable units.	No impacts.
Geographical distribution	Strongly positive impacts on integration of neighbourhoods. Will favour growing urban areas where housing developments are currently taking place.	Strongly positive impacts on integration of neighbourhoods. Will favour growing urban areas where housing developments are currently taking place. Will be better implemented in urban areas that already have significant municipal capacity.	No impacts.
Racial equity	Strongly positive impacts due to neighbourhood integration.	Strongly positive impacts due to neighbourhood integration.	No impacts.
Vulnerable groups	Limited positive impacts since target is ‘affordable’ market. Will have greater positive impact the more the emphasis is on social/rental housing.	Limited positive impacts since target is ‘affordable’ market. Will have greater positive impact the more the emphasis is on social/rental housing.	No impacts.

Criterion	*Option 1*	*Option 2*	*Option 3*
Health & Environment			
Health	No impacts.	No impacts.	No impacts.
Environmental	If the policy results in shorter commuting distances and in more dense urban form it will have positive energy use and urban air quality impacts.	If the policy results in shorter commuting distances and in more dense urban form it will have positive energy use and urban air quality impacts.	No impacts.

7. Enforcement and sanctions

The policy as it currently stands suggests that it will be largely the responsibility of developers to ensure that affordable housing in inclusionary developments is sold to appropriate buyers. Corruption, lack of buy-in to the policy objectives, and/or weak administration could see affordable housing being allocated to individuals other than the intended beneficiaries. Mechanisms are needed to help the market self-exclude people not within the target market, for example, restrictions on the title deed, requirements that buyers live in the property themselves rather than rent it out, restrictions on structural amendments or additions to the relevant units, etc.

Municipalities together with the NDoH will need to undertake compliance audits to ensure developers are charging appropriate prices, beneficiaries are in the intended target/income group, and schemes are providing good quality affordable housing appropriate to high-value land (rather than cheap, low quality housing). Municipalities at present have very limited capacity to perform such audits.

Municipalities will require improved capacity to administer the policy effectively, i.e. to speed up the approvals process in order to reduce holding costs, and provide the necessary bulk infrastructure to facilitate densification. If municipalities are unable to provide such capacity, as a result of skills shortages or lack of funding, the burden of compliance risks pushing developers out of the market.

8. Monitoring and review

From the perspective of costs and benefits it is important that a monitoring programme should develop indicators to assess the key factors that will affect the benefit-cost ratio, so that continual improvements to the policy and its implementation can be made. These would include:

- Indicators of whether IHP recipients are located closer to their place of work than where previously located, or than they would otherwise be located.

- Indicators of costs of implementation for municipalities.

- Indicators of costs of compliance to developers and of the scale of benefits received by way of incentives offered. A possible approach would be to establish a reference sample of housing developers at various scales (small, medium and large) and require or request them to complete a regular survey/report on the impacts of the policy on their developments.

As the policy impacts are relatively easy to measure and monitor and as policy refinements can be made without undermining the broad regulatory intention, it is recommended that reviews should be undertaken at regular intervals, possibly every 6 months or at least annually.

9. Consultation

Respondents included representatives of the National Departments of Housing, Land Affairs and Treasury, together with various external stakeholders including sector experts, private sector developers, SAPOA and academics.

10. Summary and recommendation

The proposal for inclusionary housing assumes that government will be able to match private sector developer incentives to the regulatory burdens imposed. If IHP in its implementation fails to match incentives to regulatory burdens, it risks driving private sector developers out of the market for both affordable housing and up-market housing.

Provided that the incentives to developers match the burdens imposed, the benefit-cost ratio of the inclusionary housing policy for both the CIS and VPADD options 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 the compliance costs, the policy results in a net loss to society in economic terms, before factoring in non-quantifiable social benefits.

While the VPADD option will be more likely than the CIS option to result in a matching of incentives to compliance costs, in cases where municipalities are weak, the VPADD option will require significant spending on improved administration, reducing its attractiveness in economic terms.

The CIS option would appear to be preferable where municipal capacity is weak, and the VPADD option preferable where municipal capacity is strong. It is not possible at this stage to say which of the two options (CIS or VPADD) is more cost-effective. This being the case, the RIA endorses the NDoH’s policy of pursuing both options simultaneously.

It is recommended that 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.