Ex post evaluation – South Africa

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Sector: Low-cost housing (CRS Code: 16040)
Project: Rural Low-Cost Housing Fund Phase 1; BMZ No. 1996 65 142 (Project A)*, AM Rural Low-Cost Housing, BMZ No. 1999 70 088 (Project A), Rural Low-Cost Housing Fund Phase II; BMZ No. 1999 65 500 (Project B)
Programme-/Project executing agency: Rural Housing Loan Fund (RHLF)

Ex post evaluation report: 2014

		Project A (Planned)	Project A (Actual)	Project B (Planned)	Project B (Actual)
Investment costs (total)	EUR million	27.10*	27.10*	21.74	21.74
Own contribution	EUR million	0.00	0.00	9.24	9.24
Funding	EUR million	27.10	27.60	12.50	12.50
of which BMZ budget funds	EUR million	27.10	27.60	12.50	12.50

*) Projects in 2014 random sample; *incl. accompanying measure (Planned: EUR 1.53 million, Actual: EUR 2.03 million)

Description: In the first phase, the project comprised the establishment and capitalisation of the Rural Housing Loan Fund (RHLF) from German grant funds. In the second phase, the RHLF was provided with a concessional FC loan of EUR 12.5 million to expand its lending activity. The RHLF was originally planned as a special revolving fund for rural housing construction within the National Housing Finance Corporation (NHFC), but was restructured in 2000-2002 into an independent non-profit enterprise that reports to the South African Department of Human Settlements. The funds for both phases supported the funding of loans disbursed via financial intermediaries to poor families in rural areas. The small loans are used to finance improvements and expansions to residential housing as well as "incremental housing". Additionally, an accompanying measure to both phases was financed amounting to EUR 2.03 million to support the RHLF and the financial intermediaries.

Objectives: The ultimate objective was to achieve a sustainable improvement in living conditions for the poor rural population of South Africa. The project objective was to improve living conditions and the living environment of the target group.

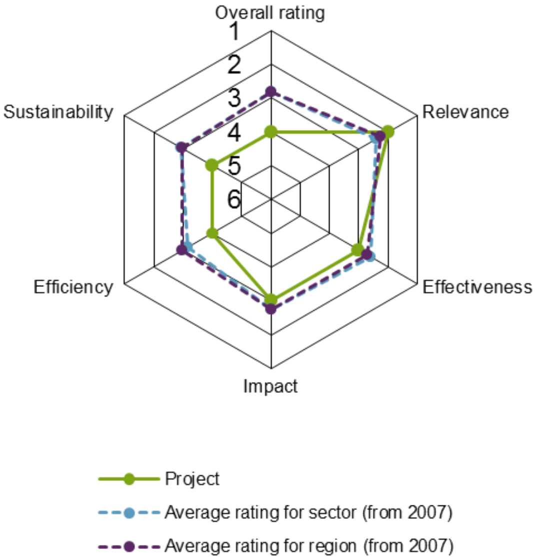
Target group: The target group of the project was poor households in rural areas. In 1996 the household income of the target group – depending on the region and size of household – was around DM 350-800 per month (ie. less than 400 EUR per month), which at that time corresponded roughly to the average for the overall population. The income ceiling was gradually raised to the current equivalent of approximately EUR 1,000/month. Obtaining a loan is subject to receiving a regular income.

Overall rating: 4 (both project phases)

Rationale: The situation is somewhat ambiguous 18 years after the establishment of the RHLF. On the one hand, poorer, rural groups of the population have access to funds to finance housing construction, and more than 400,000 loans have been provided to the target group between 1996 and 2014.

On the other hand, these loans go hand-in-hand with excessively high effective annual interest rates for small loan amounts with short terms, which are aimed specifically at poorer customers. Efforts to "leverage" the public funds of the BMZ with commercial funds did not succeed to any notable extent either.

Highlights: The project demonstrates the limitations of a financial sector approach to improve the living standards of the poorest people. Providing access to loans only helps where the benefits of the loans outweigh their costs. In this particular project the financial benefit of the investment was too low, since – apart from avoided rental payments – no cash flows were generated (despite the very high developmental value of covering fundamental needs), while the costs of lending were extremely high. Providing access to loans only helps if and when the benefits of the loans outweigh their costs.



Rating according to DAC criteria

Overall rating: 4

The project shows the limits of reaching poor households by means of this financial sector project in a specific case. Although it was possible in principle to provide access to credit for low wage earners, this was linked with much higher costs than initially anticipated in 1996. In the case of low loan amounts (specifically: loans with a lending volume lower than EUR 500 equivalent), the resulting costs of borrowing were and are disproportionate to the benefits of a micro-credit not used in a productive fashion (in spite of the limited profit expectations of all involved). We consider the approach as unsuitable for reaching poor and very poor target groups. Despite the high costs, the RHLF has continued lending to this segment of the population to date (at very high costs for the ultimate borrowers).

On a positive note, it should be noted that the maximum income limit and thus the potential volume of credit were extended several times during implementation. The project approach is significantly better suited to creating access for the “upper low-income segment” to funds for financing housing construction. In this income segment, a positive impact can be attributed to the project.

The following evaluation comprises both Phases I and II. In Phase I, the newly established fund was equipped with the necessary equity capital. In Phase II the RHLF obtained a long-term, low-interest FC credit line from budget funds of the Federal Ministry for Economic Cooperation and Development in order to expand its lending capabilities. At the time of the evaluation (2014), lending activity was based on equity capital and the FC credit line as well as on retained earnings and contributions to equity capital on the part of the South African government. The approach of initially equipping the fund with equity capital and subsequently granting a long-term, soft loan appears, in principle, to be a sensible option, even when considered ex-post. It is not possible to causally attribute the current impacts to the non-repayable financial contributions (Phase I) or the loan (Phase II). A differentiated assessment of the FC non-repayable financial contributions on the one hand and the FC credit line on the other hand does therefore not appear to be useful.

General conditions and classification of the programme

With an annual GDP per capita of around USD 11,000 (World Bank data according to the PPP method), South Africa is one of the “richer” countries in Sub-Saharan Africa. Since the end of apartheid in 1994, however, the government has only partly succeeded in abolishing inequalities in the country. As a result, according to the assessment of national poverty, almost one in every two South Africans was considered poor in the year 2011 (< EUR 69 per month). One of the areas in which the inequality following the end of apartheid became particularly evident was the housing situation. This is because, under the old system, the black population was neither permitted to purchase property nor to use financial services. As a result, the majority of the black population lived in traditional huts in rural areas or in rudimentary mass accommodation or in townships.

Relevance

The project addressed one of the core social problems in South Africa and fit well with the South African sector policy of the time. In 1996, with the aim of covering the demand at the time for 2 million housing units, the South African government adopted an ambitious housing policy consisting of three core elements. A low cost housing programme was established by the state for the poorest households (those with an income of up to approximately DM 1,000 per month at the time). Households with higher incomes (which were excluded from borrowing on the basis of apartheid legislation) were to be integrated into the existing financial market for the high and middle income segment. Furthermore, national funding institutions were founded for niche markets that the commercial banks would not cover promptly.

The present project addressed the final element, in that, with the support of German financial cooperation, a national funding institution was established under the umbrella of the Department of Housing (later the Department of Human Settlements). The mandate of this institution was to underwrite small construction loans for the gradual construction or expansion of housing (“incremental housing”). The target group for these loans were households which lived on farm land or on tribal lands and thus – due to non-existent collateral for a mortgage – were excluded from commercial loans and from government-provided housing as well and earned between around DM 350 and 800 equivalent per month.

Eighteen years later, the core problem continues to exist. As a result of economic stagnation and the demographic growth over time,[1] there is still demand for almost 2 million additional housing units. Although a number of formal and non-formal players now offer financial services to those with low incomes, households with incomes up to roughly EUR 1,000 per month continue to face financial difficulties.

The results chain – enabling independent construction projects by means of a range of micro construction loans – appears in principle to make an appropriate contribution towards solving the core problem. In this context, the results chain was based on the assumption that it would be possible to underwrite loans with moderate interest rates to poorer rural segments of the population.

At the time of the programme design and appraisal (1996), it could not be foreseen that the provision of small home loans in rural areas would be associated with very high administrative costs (the result of high distribution costs and default rates, among other things) and thus also with prohibitively high effective interest rates. On the one hand, rapid economic growth and increased income rates for large segments of the population were expected as a result of the spirit of optimism directly after the end of apartheid; on the other hand, in the 1990s there was only limited experience at international level with small loans in rural areas.

Since the core issue of providing the population with sufficient housing is as relevant today as it was then, because the project was well embedded in the South African government's housing strategy at the time and because the chosen self-help approach appeared to be coherent in view of the situation at the time, we assess the relevance as "good".

Relevance rating: 2

Effectiveness

The objective of the project was to improve housing conditions for the target group. As the indicators established at project appraisal and their benchmarks no longer correspond to the current state of the art, new indicators were assessed.

Indicator	Status at ex-post evaluation (2014)
RHLF:	
Preservation of equity capital in ZAR in real terms.	Partially met. The retained earnings of the RHLF (ZAR 99 million as at 31 March 2014) do not compensate in full for the inflation-related depreciation of the equity capital.
Portfolio at Risk (PaR) (+90 days) of the RHLF <5% and defaults <3%.	Met Current arrears are at 1% and are likely to rise to 4% by the end of the current financial year. No defaults have been recorded since 2011.
The selection of financial intermediaries by the RHLF is carried out in accordance with clear guidelines and ensures a financially stable cooperation.	Met

[1] In the observation period between 1996 (project start) and 2014 (time of ex-post evaluation), the population of South Africa grew from around 40 million to around 53 million.

Increase in annual granting of sub-loans.	Partially met; the number of loans and the actual volumes of credit are increasing moderately. The growing proportion of loans which are small, yet very expensive for the borrower should be viewed critically. 2009/2010: 30,000 sub-loans 2013/ 2014: 44,000 sub-loans Aggregate lending 1996 - 2014: 415,134 loans
Financial Intermediaries (FI):	
Portfolio at Risk (PaR) (+90 days) of the end borrower <15 %[2] and defaults <5 % or below the national average.	Partially met Although arrears and defaults are higher than 15% for almost all FIs, these are lower for most RHLF's financial intermediaries than for other comparable FIs.
Financial sustainability of the FIs (or at least real capital preservation).	Partially met Five of the eight financial intermediaries are currently reporting losses. Bearing in mind that it falls within the mandate of the RHLF to establish new agents as well, which are often not profitable in the first few years, the quality of the RHLF's "overall portfolio" seems justifiable. The fact that a relatively high level of lending activity is concentrated on just a few financial intermediaries appears problematic.
80 % of the loans and credit volumes are awarded to borrowers with an income that falls within the defined income range. 80 % of the loans are used for housing construction.	Largely met Lending to the target group in 2013/2014 based on the number of loans: 87 % Lending volume to target group: 68 % Lending for housing construction: 94 %
The cooperation with the FIs ensures the extensive granting of loans	Largely met; financing of housing construction is offered on a virtually nationwide basis. Due to legal requirements, lending in South Africa is limited to those receiving a regular income. Informal workers and the self-employed are largely excluded from borrowing.
The FIs have a "sustainable product policy" and the principles of responsible finance are applied.	Met to a limited extent As a matter of principle, a thorough appraisal of debt sustainability is carried out by the financial intermediar-

[2] This is settled contractually between the RHLF and FI.

	ies in each individual case. Sometimes, FIs grant micro-credits with unacceptable interest rates. In the case of all financial intermediaries, the interest rates and fees fall within the upper limits as defined in the National Credit Act of 2005. In the case of low credit volumes, the fees result in effective interest rates of up to 400 % p.a. which – as discussed – are legal, but not deemed acceptable in terms of development policy. These high effective interest rates are not specific to RHLF financing. They result from the fact that the South African micro-finance market – unlike in other countries in which micro loans are used largely productively – is strongly influenced by consumer loans. In the South African micro-finance market, a non-payment culture has established itself, with loan defaults in the order of 30 %. High default rates in connection with high distribution costs in thinly populated rural regions lead to high borrowing costs.
Ultimate borrowers:	
The ultimate customers are adequately informed of the consequences and costs of borrowing and make informed decisions.	Not met According to a 2010 impact assessment[3], as part of which around 930 RHLF end borrowers were surveyed, 45 % of ultimate borrowers were not sufficiently informed of the consequences of borrowing. The RHLF recognised this problem and has taken measures since 2010 to improve the level of information provided to customers.
80 % of ultimate borrowers are satisfied with borrowing (procedures for borrowing and the quality of the financed construction measures).	Met 89 % of those surveyed would recommend the relevant FI to a friend (2010). Furthermore, the visits of the evaluation mission to the ultimate borrowers highlighted the fact that they are, to a large extent, satisfied with the quality of construction. There are considerable differences in the quality of the construction. This fact is perceived as a natural limitation of the selected approach of self-help housing construction.

*) The status at the PA is not shown as the RHLF was newly founded and therefore no data is available for 1996.

[3] Although data relating to the impact of the project – and which extended far beyond the possibilities of an ex-post evaluation – was collected within the framework of the 2010 impact assessment, only limited assertions could be made on the basis of this data. This is because the assessment to measure impacts encountered problems when it came to finding ultimate borrowers for the survey (57% of the random sample had to be replaced).

Although a significant proportion of the indicators were fulfilled, the effectiveness of the project can only be rated "satisfactory" at best since two important indicators were not fulfilled. Firstly, not all financial intermediaries respect the principles of responsible finance: some offer the target group small loans with irresponsible interest rates. In combination with the penultimate indicator, which shows how low the ultimate borrower's level of basic financial education is, this represents a major weakness of the project. Given this – at times – irresponsible lending, the achievement of the project objectives can only be rated at just satisfactory, despite the high number of loans granted totalling over 400,000 and despite the fundamentally successful development of financial intermediaries.

Effectiveness rating: 3

Efficiency

Although neither the financial intermediaries nor the RHLF make significant profits, nor do they handle funds inefficiently, supplying the lowest income segment of the target group with loans results in high costs (low credit volumes, high degree of supervision, very high default rates). These costs (along with various fees) are shifted onto the ultimate borrower who, in extreme cases (micro-credits of EUR 70 equivalent over 6 months) has to contend with unacceptably high annual effective interest rates of around 400%. As it is not possible for the lowest income segment of the target group to receive higher loan amounts, the cost efficiency of reaching this segment of the target group is unsatisfactory. The average credit volume over the past year was EUR 380. A significant proportion of the loans therefore fall into this problematic segment.

Only loans upwards of around EUR 500-700 appear to result in an acceptable cost-benefit ratio (effective yearly interest <50%). These loans were also underwritten as part of the project as the RHLF increased the maximum income limit several times over the course of the project (from DM 350 per month at the programme appraisal in 1996 to EUR 1000 per month in 2014). If we only consider this business segment, the cost efficiency of the project approach appears acceptable in retrospect.

The relatively high cost of setting up and developing the RHLF also appears acceptable in hindsight. The RHLF was first advised by international experts in the development phase, then during the divestiture of the RHLF from the National Housing Finance Corporation and finally during a time of crisis within the South African micro-finance sector. The relatively high number of employees of the RHLF (15), measured in terms of the number of new credit lines per year (13), is justified by the fact that the RHLF has helped to establish many financial intermediaries over and above its function as an on-lending institution and plays a role as a knowledge broker in the sector. In particular, cooperation with Community Based Organisations (CBOs) – which are smaller but significantly closer to the target groups – goes hand-in-hand with fairly high administrative costs for the RHLF.

The RHLF can occasionally absorb some of the defaults of smaller individual intermediaries and generates moderate profits which are added to equity capital. However, the retained earnings of the RHLF (ZAR 99 million as of 31 March 2014) are unable to compensate in full for the inflation-related depreciation of the equity capital. As a result of the intensive focus on lending to the lowest income segment, the RHLF has not yet succeeded in leveraging the budgetary funds of the German Federal Ministry for Economic Cooperation and Development with commercial refinancing. The South African Department of Human Settlements, with an equity capital injection of ZAR 130 million (corresponding to around EUR 9.24 million), is the only other source of funding. As the RHLF implemented the resources more slowly than planned at appraisal, the implementation period was twice as long as that set out in the very ambitious plans. The reasons behind this extended timeframe are the divestiture of the RHLF from the NHFC, the cooperation with major South African banks – initially planned but never materialised – and a temporary crisis in the South African micro-finance sector.

The efficiency of the financial intermediaries is rated satisfactory with some limitations in that there is a high degree of heterogeneity. The visits to some financial intermediaries and their balance sheets illustrate that they did not use the favourable refinancing to generate high profits. However, the field visits also made it clear that the structures are very labour-intensive and there are often overlaps between the various financial intermediaries, which supports competition but also contributes to the very high costs of lending. The majority of the financial intermediaries use only their equity capital and RHLF credit lines to underwrite housing loans. Only a few “leverage” the concessional RHLF funds with commercial refinancing.

Evaluating the efficiency of the project is thus a task of two parts. The cost efficiency is unsatisfactory when it comes to reaching the lowest income segments of the target group.

For those in the target group earning a higher income and who also receive loans with higher volumes of credit starting at around EUR 700, the cost efficiency is satisfactory.

As a result of the relatively high proportion of small and micro-credits amongst the total number of loans granted, we deem the overall efficiency to be no longer satisfactory.

Efficiency·rating:·4¶

Impact

The overall objective of the project was to contribute to improving the living conditions amongst the poor rural population. The indicators defined at project appraisal in 1996 (number of houses built, satisfaction with build quality) do not correspond to the current state of the art for overall objective indicators and were thus replaced with indicators which represent the end of the results chain.

Indicator	Ex post evaluation
The project has contributed towards reducing social tensions in the country.	In 2010, 90 % of those surveyed reported that they had increased self-esteem and were more respected as a result of the extension/new construction (funded using the loan). We assume that this has had a positive effect on reducing social tensions.
The project has helped to improve the health situation.	Relocating a household from mass accommodation, a corrugated-iron hut or a traditional house into what is usually a considerably larger stone house fundamentally reduces the risk of infection with diseases. What is more, 25 % of those surveyed reported better cooking facilities, improved sanitary conditions and access to electricity – factors which also have a potentially positive effect.
The project has contributed towards increasing security for the target group.	3.5 % of the ultimate borrowers used their loan for security measures (doors, windows, fences). As a result of its impact on employment, the project has shown a tendency to contribute to the reduction of crime.

Serious curtailments in the developmental impact of the project must, however, be made once again due to the high costs of credit. The decision to finance construction on the basis of a loan rather than using savings leads to extremely high costs in some cases. Although no relevant data is available, it is highly probable that apart from the positive developmental impact covered by the above mentioned indicators, the project has had a negative impact on the economic situation of some of the ultimate borrowers. However, it should be taken into consideration in this context that the RHLF only funds unsecured loans. This means that, unlike a mortgage loan, in the event of inability to pay (as a result of illness or unemployment for example) the borrowers “only” lose their creditworthiness, not their home.

Further curtailments relating to the impact of the project must also be made in relation to reaching the target groups. Putting aside the fact that the threshold at which the costs of the loans are proportional to the benefits is higher than was expected at the appraisal, it has not been possible to integrate informal workers, who make up approximately 25-30 % of the working population. As a result of the National Credit Act of 2007, which requires proof of regular income, it is difficult or even impossible for the financial intermediaries to award loans to informal workers. Only Community Based Organisations (CBO), which are not subject to the National Credit Act, are able to reach this target group. Thus far, however, the CBOs have awarded only a very small proportion of the end loans and credit volumes, and it appears somewhat doubtful whether CBOs are in a "better" position to grant loans than financial intermediaries.

The overall assessment is extremely difficult as on the one hand we have a group of borrowers who have been able to finance the construction of their own homes thanks to RHLF financing, and on the other a group of borrowers for whom borrowing has presumably done more harm than good as a result of the high fees. Taking into account all the factors, we assess the developmental impact as just satisfactory.

Impact rating: 3

Sustainability

The RHLF makes moderate profits (which, however, were insufficient to actually maintain its equity capital at the full amount in the period 1996-2014, as shown), has withstood periods of crisis in the micro-finance sector and has a good risk management system. Furthermore, the RHLF has a qualified and motivated team of staff as well as backing in parliament and government. In this respect, the RHLF would in principle be able to continue its activities in the present way in terms of nature and extent.

From a developmental perspective, the South African government or the RHLF itself must redefine their role. This evaluation concludes that promoting lending to the lower income segment of the target group is unacceptable from a developmental impact point of view due to the high effective interest rates. In this respect, the RHLF should cease to support the granting of micro-credits below approximately EUR 500 via commercial financial intermediaries, or find a way and means of drastically reducing the fees for micro-credits. Furthermore, it is uncertain whether there is a medium and long-term role for the RHLF in the refinancing of "larger" housing construction loans (> EUR 500) to earners of "moderate incomes" (up to roughly EUR 1000/month). Existing South African financial intermediaries could potentially finance this type of loan from their own funds.

Furthermore, it is crucial for the future of the RHLF whether the idea of combining the RHLF with other state housing construction institutions to form a national housing promotion association (as suggested back in 2009) will be implemented in the coming years. As this merger is one of the new government's priorities, this idea seems once again to be very topical after several years of stagnation.

Finally, it should be noted that despite the curtailments which had to be made in terms of accessibility for the target group, it was possible to anchor important knowledge relating to loans for low cost housing construction at the RHLF, which benefited the whole sector. A good example of this is that the RHLF developed target group-oriented guidance material relating to housing construction very early on, and took up a leading role in the fight against construction materials containing asbestos.

Sustainability rating: 4

Notes on the methods used to evaluate project success (project rating)

Projects (and programmes) are evaluated on a six-point scale, the criteria being **relevance, effectiveness, efficiency** and **overarching developmental impact**. The ratings are also used to arrive at a **final assessment** of a project's overall developmental efficacy. The scale is as follows:

Level 1	Very good result that clearly exceeds expectations
Level 2	Good result, fully in line with expectations and without any significant shortcomings
Level 3	Satisfactory result – project falls short of expectations but the positive results dominate
Level 4	Unsatisfactory result – significantly below expectations, with negative results dominating despite discernible positive results
Level 5	Clearly inadequate result – despite some positive partial results, the negative results clearly dominate
Level 6	The project has no impact or the situation has actually deteriorated

Ratings level 1-3 denote a positive assessment or successful project while ratings level 4-6 denote a negative assessment.

Sustainability is evaluated according to the following four-point scale:

Sustainability level 1 (very good sustainability): The developmental efficacy of the project (positive to date) is very likely to continue undiminished or even increase.

Sustainability level 2 (good sustainability): The developmental efficacy of the project (positive to date) is very likely to decline only minimally but remain positive overall. (This is what can normally be expected).

Sustainability level 3 (satisfactory sustainability): The developmental efficacy of the project (positive to date) is very likely to decline significantly but remain positive overall. This rating is also assigned if the sustainability of a project is considered inadequate up to the time of the ex post evaluation but is very likely to evolve positively so that the project will ultimately achieve positive developmental efficacy.

Sustainability level 4 (inadequate sustainability): The developmental efficacy of the project is inadequate up to the time of the ex post evaluation and is very unlikely to improve. This rating is also assigned if the sustainability that has been positively evaluated to date is very likely to deteriorate severely and no longer meet the level 3 criteria.

The **overall rating** on the six-point scale is compiled from a weighting of all five individual criteria as appropriate to the project in question. Ratings 1-3 of the overall rating denote a "successful" project while ratings 4-6 denote an "unsuccessful" project. It should be noted that a project can generally be considered developmentally "successful" only if the achievement of the project objective ("effectiveness"), the impact on the overall objective ("overarching developmental impact") and the sustainability are rated at least "satisfactory" (rating 3).