



KZN Housing

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POLICY GUIDELINE FOR THE ADJUSTMENT OF THE SUBSIDY AMOUNT AS A RESULT OF INFLATION

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TABLE OF CONTENTS

1.	INTRODUCTION	1
1.1	Background.....	1
1.2	Purpose.....	2
1.3	Guiding principles	2
2.	POLICY GUIDELINE	3
2.1	Blocked projects	3
2.2	Alignment of the subsidy amount	3
3.	APPLICATION CONSIDERATIONS	4
4.	MONITORING AND EVALUATION	5

1. INTRODUCTION

1.1 BACKGROUND

In 1994 the National Government initiated the Capital Subsidy Scheme in an attempt to address the plight of homeless people. This was to be implemented via the various programmes and mechanisms within the broad National Policy prescriptions. The National Department has over time included new mechanisms in an attempt to meet a variety of housing needs of varying circumstances.

Due to various factors many projects became blocked or were in danger of becoming blocked in due course, as delays in implementation had resulted in adverse cost implications to the projects due to inflationary cost factors. These delays included capacity problems within the department and the municipality, procedural delays (CMIP/MIG, DFA), etc.

Inflation in the cost of goods, over the past years, has been rampant and this has resulted in the subsidy amount being insufficient to deliver the specified product. This also resulted in many projects being delayed and blocked. Inflation is also an ongoing problem and the current subsidy amount, although increased annually, is not sufficient to cover the cost of a beneficiary's house or services over the project period. Projects will therefore be continuously blocked if the problem of escalation is not addressed. The number of blocked projects will increase, as new projects approved will also become blocked.

The National Department of Housing acknowledged the problem and in August 2003 approved guidelines for the unblocking of projects affected by escalation. These guidelines were, however, a re-active approach to inflation and were only meant to accommodate blocked projects approved before or on 31 March 1999. The guidelines also stipulated an increase up to a ceiling amount of only R20 300.00, plus the 15% geotechnical allowance. The initiative from the National department was a crisis reaction and did not address the long term and fundamental underlying issue of inflation. The ceiling amount was also not based on actual cost or scientific calculations.

The Province extended its interpretation of this policy and considered projects approved after March 1999 and it included an approach called the "Rescue Funding" approach. In terms of the Rescue Funding approach, projects that were blocked after 31 March 1999, where service construction had not commenced and projects that were envisaged to be blocked were allowed to make application for an increase in funding up to the prevailing subsidy amount. This resulted in many projects becoming unblocked. However, this approach was not documented or formalized into a Provincial policy.

The National Department, in a further attempt to address the effects of escalation, amended the methodology for determining the subsidy amount. The current system was introduced in terms of which the subsidy is increased annually in accordance with the Bureau of Economic Research and the Building Cost Index (BER-BCI). The increase is however only for new projects approved in a particular financial year and it fixes the subsidy amount for the life cycle of the project. Inflation is not taken into account and projects not completed within that financial year will therefore not be able to deliver its products as inflation is in excess of the original approved amount.

The average life cycle of any project varies between 3 to 5 years hence fixing the subsidy amount at the time of the project approval is not a feasible means to cover the effects of inflation adequately. The Provincial Department, once again on its own initiative, in an attempt to counteract the effects of inflation introduced a process that allowed for projects to be approved in 2 phases: Phase 1- *Serviced Stand*; and Phase 2 - *Top Structure*.

The rationale was to prevent insufficient funding at the top structure stage, especially since it takes 2 to 3 years for a project to reach this stage.

The Provincial process only addressed shortfalls of monies to construct the top-structure and did not take into consideration the fact that services monies (formerly known as the P3 milestone) are also affected by escalation and that the time consuming processes, delays and problems in projects are mainly experienced at the Planning and Design stage, i.e. milestones leading up to the approval of township establishment. The Provincial process also did not take into consideration projects that are close to or at the top-structure stage and because of inflation, cannot deliver the product.

1.2 PURPOSE

The Province has been very pro-active in developing its own policies and has conquered many obstacles and made great strides as far as housing delivery is concerned. Escalation however is one problem which is still plaguing development and in view of the above facts it is imperative that a vehicle be developed to counteract the effects of inflation.

The subsidy amount available for house construction is specific to a particular year. It does not cover the project cycle and thus does not incorporate an inflationary element. The new provincial guideline seeks to address this and deals broadly with two scenarios:

- a. Projects effected by escalation due to blockage encountered by the developer, beyond his/her control; and
- b. the annual alignment of projects to the new subsidy quantum to proactively address the effects of escalation.

It also provides for guidelines to deal with current projects and new projects (paragraphs 2.2.c-d) in terms of the different subsidy quanta recommended by the National Department of Housing.

1.3 GUIDING PRINCIPLES

The updated policy is guided by the following principles:

- Additional funding for purposes of escalation should not encourage developers to delay projects.
- It should not allow for any party/parties to be unjustly enriched.
- The mechanism to address inflation should not be seen as a means of encouraging double subsidization.

The National Department of Housing acknowledged the need to combat the effects of inflation by increasing the subsidy on an annual basis. These increases are based on prevalent indices. The expected product price of a 30m² or 40m² structure (less R2479 contribution) amounts to the subsidy amount at a given year, and applies to projects approved in that same financial year. The subsidy amount is based on the BER – BCI (Bureau of Economic Research and the Building Cost Index) which reflects price increases in the low-cost housing market.

2. POLICY GUIDELINE

This guideline must be read in conjunction with the “Guideline For The Adjustment Of Pe project process is generally made up of 4 stages. Risk assessment is done in 2 stages. The first is the Project Description Stage (Conditional Approval) and the second is the Project Feasibility stage. The third stage of the project process is the Implementation stage. The final stage is concluded by the project close-out.

2.1 BLOCKED PROJECTS

The approach to deal with escalation of project costs where developers failed to comply with the approved development programme to meet targets due to circumstances beyond their control and did not succeed to deliver on time, will be as follows:

- a. The **BER-BCI and/or the Haylett Formula Index applicable** for that period must be used in applications for escalation funding.
- b. The request for escalation must be substantiated by proof of cost escalation measured against the agreed product price.
- c. The agreement must include the revised development programme, and clearly indicate deliverables planned for each financial year. Alignment will not be effected until the agreed milestones for a particular year had been completed.
- d. The amount claimed must not exceed the applicable subsidy quantum for current and blocked projects for that financial year.

2.2 ALIGNMENT OF THE SUBSIDY AMOUNT

The alignment of the subsidy quantum will be applicable to approved projects that have to address the effects of inflation on material and labour costs. This approach will be as follows:

- a. Applications for the alignment of the subsidy quantum must not include changes in the number of sites or any other conditions of a project as originally approved by the MEC. However, should there be a change in the yield of sites in the township establishment process, a detailed motivation must be submitted.
- b. Alignment of subsidies will only be applicable to undeveloped sites of the project and work in progress, where applicable.
- c. Where the project was approved prior to 1 April 2007 and the house specification is not aligned to the new two-roomed 40m²house (i.e. project approval related to the 30m² minimum top structure), the adjustment of the subsidy must be linked to the prevailing subsidy amount applicable for that financial year for current and blocked projects as approved annually by MinMec. In these cases, the difference of the 15% variation should apply, should it be applicable (i.e. 15% variation on the product cost). Where the variation was previously applied in respect of services, however, no new variation should be calculated.

- d. Where the project was approved on or after 1 April 2007 and/or the house specification is aligned to the new minimum requirements and specifications (currently relating to a two-roomed 40m²house), the subsidy could be aligned to the new subsidy quantum applicable at the time. Any variation amount is to be calculated in terms of the variation calculator. Such alignment will only apply to units not completed, and any variation should be calculated accordingly.
- e. The subsidy adjustment must be included in the project agreement and addenda.
- f. All adjustments in respect of the alignment of the subsidy must be in line with an approved development programme. Alignment will not be effected until the agreed milestones for a particular year had been satisfactorily completed.
- g. All agreements including the Tripartite Agreement that is entered into should be strictly managed and must spell out the measurable targets and penalties.
- h. It is suggested that to alleviate future applications for inflation linked funding, project applications be submitted in phased portions in terms of the National Department of Housing Guidelines for a Phased Development Approach i.e.: Phase 1 consisting of the cost of the production of a serviced stand and Phase 2 consisting of the cost of the top structure. This means that the subsidies allocated may differ from the specific housing subsidy amount calculated annually i.e. the serviced stand may be based on the subsidy for the 2007/8 year and the top structure may be based on the subsidy for the 2008/9 year, etc. Such phases should take cognisance of all activities that can take place during this period.
- i. Projects should also be phased in terms of the number of achievable sites within a financial year, as per the agreed development programme. Thus, care needs to be taken to ensure realistic development programmes are submitted.

3. APPLICATIONS CONSIDERATIONS

Project approval and administrative processes need to contribute towards minimizing the affects of inflation. This can be achieved as follows:

- a. Project applications need to be complete with all the correctly completed attachments, signatures and certificates.
- b. Premature submission of project applications must be avoided.
- c. Project applications for final feasibility stage approvals should be for the entire the in principle, together with the implementation stage, calculated at the subsidy applicable at the time of application. A provision should be included for the balance of the project to be approved according to the development programme, and at the subsidy applicable at the time of implementation.
- d. The application should include a programme that is calculated in terms of the number of months/weeks after the signing of the agreement. This programme will for the baseline in terms of the agreement. Revised programmes should be submitted and formally approved on a regular basis.

- e. A revised development programme and associated cash flow needs to be submitted, and scrutinized by the departmental project monitor and team leader, and submitted to the regional manager for approval, prior to effecting adjustments.

4. MONITORING AND EVALUATION

The effectiveness of the guideline will be monitored on an ongoing basis and adjustments will be made where most needed and communicated to all stakeholders. A review should be undertaken at least once in a MTEF cycle (thus once every 3 years).