

# CRE PERSPECTIVE

## SOUTH AFRICA, POST-APARTHEID

by J. R. Kimball, CRE

South Africa . . . a.k.a., "The Dark Continent." The name calls to mind safaris, wars, apartheid, violence, and mystery. Whether sought out or accidentally encountered, the public's image of South Africa has and continues to be shaped by what we have been exposed to by the media. Thus, when offered the opportunity to visit South Africa and experience first-hand what had heretofore always been a dream, I jumped at the chance. Following is a brief overview of a visit made in the Fall of 1996 as a team member of the Citizens Ambassador Real Estate Development Delegation of the People to People Program.<sup>1</sup>

### Background

Pre-trip, my delegation's knowledge included some recollections about South Africa's history; information that was soon to expand by volumes! We had recollections of frontier wars, (nine dating back to 1779); abuses associated with apartheid; international sanctions levied against South Africa for its human rights violations; and of course, the imprisonment of Nelson Mandela for his efforts to gain equal rights for all South Africans.

Discrimination was selectively applied under apartheid. Whites were the ruling minority class; the mixed races were called "colored"; and blacks were the majority class who had no political or social standing. Although not as numerous as Afrikaners, the English-speaking community has dominated industry and commerce.

Following is an attempt to relate some facts<sup>2</sup> and a observations on the real estate market as it is emerging under the new open society created post-apartheid.

### The Government

Characterized as a multi-party democracy, South Africa achieved a transition from minority to majority rule in April of 1994, without upheaval. The African National Congress (ANC), obtained a large majority of the votes, with its candidate, Nelson Mandela, being elected President of the party. About 65 percent of the estimated potential electorate voted in a fully-democratic election; there was no formal census of eligible voters. In terms of the interim constitution, Mandela presides over what is termed the "Government of National Unity" (GNU). His cabinet includes representatives of two major rival parties: the National Party (NP), headed by Deputy President FW de Klerk; and the Inkatha Freedom Party (IFP), (the predominantly Zulu party), led by Chief Mangosuthu Buthelezi.

The current governing body consists of 400 Parliament members and 90 Senators. Most all are black, in contrast to the previous structure that was almost exclusively white. Critical issues facing the Government of National Unity, include: urbanization, which has created massive informal shanty towns surrounding established cities; legal and

illegal immigration; land reforms; job training; a Truth and Reconciliation Commission<sup>3</sup>; and the redistribution of wealth and resources.

The GNU has established a Reconstruction and Development Program (RDP). It is charged with correcting decades of racial discrimination, found especially in education, housing, job training, and welfare services. The RDP is also attempting to stimulate a weakened economy and generate jobs. Classified as a middle-income country, South Africa's per capita GDP is estimated at approximately \$2,900. Unemployment is generally estimated at 40 percent of the population eligible to work. Over 50 percent of the black population is classified as living in poverty.

Apartheid created inequities in ownership, employment, and skills, thus making for a very skewed economy in terms of individual income, skills, productivity, and employment. The low growth rate of the GDP, 3.4 percent, compared to a population growth rate of an estimated 2.4 percent, indicates little change in per capita income or employment.

The job of the RDP is to focus on: job skills; education; health care for all; housing for the backlog of an estimated 2.5 million people; access to clean water supplies and affordable sanitation facilities; a mass electrification program; and better transportation.

The RDP has not met its initial goal of providing 200,000 new housing units per year. Goals it has met include: free health care for some; annual mass electrification of 300,000 homes; approximately 600 programs upgrading municipal infrastructure; attempts to promote the small business sector; access to water for 3,000,000 people; and mass access to telecommunications.

Under apartheid, South Africa's economy had been geared toward satisfying the domestic consumption of an isolated country. This international isolation imposed by trade sanctions, left most industries with a decidedly domestic focus.

The post-apartheid lifting of trade sanctions put South Africa into global competition. This competition requires tremendous gains in productivity just to maintain status quo, let alone attempt to raise living standards and reduce economic divisions between the races. Gains in productivity can only be achieved by creating a skilled labor pool. Job training will provide the skills to be employed; employment will provide the income necessary to afford a mortgage; thus, together creating a demand for housing. The construction of houses will also stimulate economic growth by creating employment in related industries such as services, appliances, utensils, and furniture.

Foreign investment is treated the same as domestic investment. Incentives for foreign investors include: 100 percent ownership; no government approval required; substantial growth potential; access to African and Indian ocean markets; and few restrictions on exporting profits. Disincentives include: high crime rates, high interest rates, high taxes, low productivity, and restrictions on access to local credit by companies with more than 25 percent foreign control.

### **The Legal System**

The South African legal system combines elements of Roman, Dutch, and English law. Procedures are similar to those in British courts. The jury system was abolished many years ago. In addition to the Constitutional Court

there are three other levels: Magistrate's courts, Supreme courts, and the Court of Appeal.

Many thousands of acres of land, either government or privately owned, have no land or parcel descriptions. Occupancy of some parcels has been by a tribal grant of a "Permission to Occupy" (PTO). These were for extended periods of time, (99 years), and are now being converted to fee ownership as part of the land reform program. Restitution, redistribution, and compensation are all problems being dealt with by the RDP. Having the potential to be the most divisive and controversial, land reform started with a policy paper issued in February 1996. Among other things, it called for expropriation at less than market value; a land tax; the release of parcels of land for urban squatter communities; and a legislative program giving security of tenure to people living on tribal land. Additionally, property owners were assured of a hard-line on land invasions.

### **Banking & Finance**

Property finance is as diverse in South Africa as it is in the U.S. Many different programs are available, including: 1). bonds, traded in the stock market; 2). lease finance, where the payments of a credit tenant are discounted to their present worth and the proceeds used to purchase the property; 3). unsecured loans, where the borrower's name and standing are the main guarantees; 4). non-securitized mortgages, both short and long terms and at both fixed and variable rates; 5). stepped-rate lending, where the bank may require a bond for the original amount plus the anticipated total capitalized interest to be taken out; and 6). participation mortgage bonds, derived from the savings of the elderly. The criterion to obtain

appropriate financing is to have a property that is well-constructed, in a good location, and with a high quality income stream. Sound familiar?

Bank lending rates vary depending on the borrower, whether individual or corporate. There is a new venture in the parlance of South Africa called project finance. It does not have a great deal of security to offer, other than the fact that the development itself will borrow on the strength of the development.

On the other hand, corporate finance dictates that a larger and well-established company may be able to borrow on the strength of the company itself rather than its individual projects. In this instance, all cash flows are typically assigned to the bank. Loan to value ratios are 60 to 70 percent. With an annual increase in rental rates of 12 percent, an interest rate of 18 percent, and a capitalization rate of 11 percent, the rental income on a R10,000,000 (U.S. \$2,250,000) property, for example, would not cover debt service. Thus, the bank keeps all proceeds from the rental income, and loans the shortfall as an overdraft. This scheme will retire the original R6,000,000 (U.S. \$1,333,000) loan in nine years. Unfortunately, equity has had no return during this period. With a 10-year lease, equity will receive all of the tenth year's income that, with the 12 percent annual increase, now amounts to R1,711,159.00 (U.S. \$380,000). This is the preferred lending scheme of the bank. The risk factors of investing/purchasing are tenant retention, the sustainability of rental increases, IRR returns and inflation, the crime rate, and of course a stable political environment.

### **The Housing Market**

Housing is the most critical

problem facing South Africa. Residential developments fall into two classes; formal and informal. Formal are platted, serviced subdivisions not unlike those found in this country. Informal developments, usually inhabited by squatters, are unplatted, unserviced, and have no utilities whatsoever. These settlements house the enormous numbers immigrating from other parts of South Africa to Cape Town and Jo'berg. Reports placed this number at 20,000 per month, although no accurate census has been taken. Under apartheid, blacks were not counted. However, the number seems to fairly represent the problem (judging from the number of informal settlements observed). Efforts were made to not show our delegation all of these settlements. Households with an average size of five members are being moved from informal to formal settlements as rapidly as product is made available.

The government has a subsidy program that allows first-time home buyers whose earnings do not exceed R3,500, (U.S. \$775.00), to receive R15,000 (U.S. \$3,333.00) towards purchase of a house not exceeding R65,000 (U.S. \$14,450) in a formal settlement. The problem however, is one of capacity. The houses cannot be built fast enough, and personnel cannot be trained for jobs that do not yet exist.

Over 60 percent of the SA population is urbanized. In the last four decades, apartheid restrictions on home ownership in urban areas has resulted in a housing backlog estimated at 2.5 million units. Demand is estimated to be growing by 200,000 units each year. Approximately seven million people are living in informal settlements throughout SA on land occupied legally or otherwise. The country's 240 government-built hostels have over 600,000 beds,

many often occupied by three people to a bed space. With unemployment rates of around 40 percent, four out of five households are not able to afford a mortgage.

Housing support centers are being established around South Africa for "self-build" programs. Existing housing units owned by the government are being sold to occupants, and hostels are being converted to family dwellings. Originally constructed as dormitories for miners, these hostels have outdoor communal toilets and cold water spigots. The rehab program converts these to one and two room apartments having shared, central living and cooking areas. Assignments are made with four people in a one-room unit and eight people in a two-room unit. Indoor plumbing is provided under the rehab program.

A mortgage indemnity program has been introduced to provide insurance to recognized lenders who have been deterred from lending in many areas by fear of violence, unrest, theft from building sites, and/or the culture of payment boycotts (carried over from the apartheid era). Instances of occupants unable to meet the mortgage payments are noted by the roof, roof framing, and windows being carted off and used to build a shelter in an informal settlement.

The emphasis on creating employment and job training is so strong that a recent offer by Japan to ship manufactured housing units was rejected. The importation of product would not provide the training in the trades and enable black residents to improve their situations, thus becoming more productive citizens.

Surprisingly, developers seem disinclined to attempt multi-family housing projects. This may be traceable to the native desire to own rather than rent, in an effort

not to create additional dense population centers. The informal settlements are quite dense enough. Some efforts are underway in Jo'berg to upgrade some very old multi-story apartments in the CBD. These structures were originally designed and constructed for a bachelor miners. Under the rehab program, these units will still share a common dormitory-style restroom located off the stairwell, offering little in the way of privacy. Given the average family size, the one and two room units will provide little more than a dry place with indoor plumbing.

Contractors are required to train individuals in each step of the building process so they will be able to find employment and even bid on similar work in the future. Under apartheid, a black person could not pick up a hammer, much less possess the knowledge of its use. The training is not limited to the trade skills, but includes learning the business of running a construction company. The individual is thus empowered to become a contractor.

### **The Commercial Market**

The resulting increases in population and housing have had beneficial side effects. Existing retail centers are doing well, and more are in the planning stages. The vast majority of the black population does not own automobiles, so they rely on taxis or walk to stores. The daily pattern of purchases, (largely dictated by lack of refrigeration, uncertainty of cash flow, and mode of transport), is to buy only what can be carried in two bags. Thus, developers plan their locations and retailer's stock according to the "two bag" shoppers.

When whites and blacks partner in the development of retail

outlets, it is preferred that the black party be the "front" partner. Negotiations with all special interest groups are paramount, including prospective tenants as well as the sidewalk vendors and taxi cab companies. Each has a say in the arrangement of space and location of essential services. Additionally, the developer conducts training programs in inventory control, cash management, and marketing. Overall, blacks are distrustful of developers and they tend to remain loyal to their own people or tribe and to their own brands. They lack trading competency and remain fearful of exploitation. Cultural practices dictate the acceptance or rejection of merchants. A reputation goes a long way in the success or failure of any enterprise dealing with the black public. Almost tribal loyalties to one merchant may spell doom for another that does not enjoy the community's acceptance.

A peculiarity of the shopping center rental market is the payment of "key money," whereby an existing tenant who has a five-year lease will turn the key over (subletting) to another tenant for a fee (about R25,000; U.S. \$5,500). Thus, the landlord does not always have the desired control over the tenant mix.

Shopping center rentals average R90.00/square meter per month (approximately U.S. \$20.00/SF per annum); office park rentals are R35.00/square meter per month (approximately U.S. \$7.75/SF per annum); warehouse's rent for R21.50/square meter per month (approximately U.S. \$4.75/SF per annum). Rentals are exclusive of electricity, but do include: janitorial service, security, maintenance, management, insurance, taxes, and heating, ventilation, and air conditioning. All commercial lease structures are subject to a 14 percent Value Added Tax (VAT). The VAT

is recoverable through trading, except for the end-user.

Rental or lease rates on commercial/office/industrial space carry an annual increase of 10 to 12 percent. Leases are reviewed on a five-year basis with adjustments of the base rent to market levels. This is in addition to the annual percentage increase mentioned above.

Land for office park use sells for R180.00/square meter (approximately U.S. \$3.70/SF); industrial park land sells for R165.00/square meter (approximately U.S. \$3.40/SF).

National inflation has been estimated to be only 7 percent. Interest rates are 15 to 19 percent. Yields on prime office space in the CBD are 9.5 percent; long-term industrial leases yield 10 percent; secondary industrial yields are 12 percent; and IRRs range from 18 to 22 percent. The annual rental increase obviously contributes to this rate of inflation. After all, everyone uses real estate and must pay for its use. Tenants just pass the increases to customers in the form of higher prices.

Office occupancy and construction is currently focused on the suburbs. The CBD in Jo'berg has a high vacancy rate. This is brought on by the influx of street vendors that occupy the sidewalks in front of every major building. New office parks have developed along the major arterials. Judging from the "to let" signs, they are not yet fully occupied.

### **Conclusion**

The attitude reflected by both black and white developers was one of total commitment to cooperation. There was no bitterness or resentment expressed by anyone. All are doing their best to bring success to the post-apartheid era, stimulate investment, promote

growth and job training, solve the housing problem, and bring South Africa into the world economic community.

The numbers immigrating into South Africa, the lack of employment opportunities, tribal frictions, and the overcrowded living conditions have all contributed to a rise in crime. Efforts have been made to reduce the visibility of the police force due to their history of brutality and crimes against citizens. Security features are still very evident with fencing, guards, and gated entrances. One does not have to guess about the mind set of tenants requiring this level of protection.

Counseling opportunities abound. Every action, policy, and procedure has to be re-examined. Yesterday's solutions are today's problems. Innovative thinking in providing solutions to the housing problem, the crime rate, and employment is critical. This is not to imply that South Africans are not sophisticated in their real estate practice or in their approach to their problems' solutions. Clearly, South Africans are top-notch. The opportunities exist in assisting with programs that will facilitate the movement from a segregated population in an isolated nation to an equal trading partner in the global economy.

Real estate finance, primarily in the area of affordable housing, is a critical problem. Land reform measures and the principles of land economics provide another area where Counselor's can participate. Adequate housing will alleviate overcrowding, which in turn, will help lower the crime rate. Training, resulting in marketable job skills, will reduce the unemployment rate and enable movement from informal to formal settlements.

From an outsider's viewpoint

South Africa's urban areas are analogous to a developed nation located in a third world country. So much needs to be done and in such a short time that the task seems staggering. Fortunately, English is a common language. Communication is not difficult once one gets past the differences in pronunciation and certain choices of words that a U.S. citizen may construe to mean a less than savory operation; i.e., "schemes" vs. development or project!<sup>REI</sup>

#### NOTES

1. President Dwight D. Eisenhower founded The Citizen Ambassador

Program in 1956, believing that private citizens reaching out in friendship to the people of other nations could make a significant contribution to world peace. In carrying out citizen exchanges, under the auspices and direction of People to People International, The Citizen Ambassador Program promotes friendly relations among all countries through scientific, professional, and technical exchanges. Projects are developed around specific professional objectives and major discussion topics and delegates are invited to participate based on their professional backgrounds. The intent of each delegation is the cross-cultural sharing of information, ideas, and experiences.

2. SA 96-97, *South Africa At a Glance*
3. The Truth and Reconciliation Commission was established to probe human rights abuses committed in the

course of political struggle. Its purpose is not to punish but rather to seek the truth in an effort to facilitate healing.

#### ABOUT THE AUTHOR

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