



Private Equity Investment: Easing the Housing Shortage

1. Introduction

South Africa's housing shortage has proven to be particularly difficult to overcome. Despite government efforts to provide housing for low-income households, the situation remains troublesome with a housing backlog of approximately 2-2.5 million units and continuously increasing demand.¹ The country's growing population is concentrated around urban centres, with numerous informal settlements housing 13.6% of South Africa's approximately 53 million people.

No one solution will be able to solve such an intransigent problem. It will surely require various and coordinated efforts from both the public and private sectors. This paper aims to explore one approach, though, which may help to alleviate the housing shortage.

2. Private Equity

Private equity is a type of financing provided in exchange for an ownership stake in a company or venture, which investors believe will deliver a positive return at the end of the investment horizon. Instead of raising capital through a publicly-traded stock exchange, private equity firms raise it through private investors. Private equity deals are very large – often in the hundreds of millions of rands, or even billions – and therefore require a substantial minimum investment. This makes them difficult for the average investor but well suited for institutional investors, endowments, and individuals of high net worth. They also have a longer time horizon than many other investments – typically 3-5 years or longer – making them more illiquid. At the end of the investment horizon, investors exit with their invested capital and their return on it.

3. Impact Investing

Like many types of investments, private equity has traditionally been focused on financial return and not much else. The recent rise in impact investing, though, has changed that. Impact investing is an increasingly popular investment approach that seeks to generate measurable social impact in addition to financial returns. Although less than \$40 billion of capital has so far been committed to impact investments out of the tens of trillions of global capital available, impact investing's potential is great.²

The World Economic Forum recognized impact investing's potential by launching its Mainstreaming Impact Investing Initiative in 2012, with the intention of identifying the factors necessary to accelerate capital from traditional investments to impact investments. The topic of impact investing has remained on the Forum's agenda at its annual meetings in Davos since then.

The appeal of impact investing is its ability to combine two seemingly disparate goals, namely social impact and financial return. Social impact is often thought to be the domain of government and philanthropy. While both do indeed play key roles in effecting positive social change, they are inherently limited by budgetary constraints and finite donated funds. Capital markets, meanwhile, have an ample supply of money to be invested, but are driven by the prospect of financial return.

By directing capital toward impact investments, both goals can be met, thereby achieving social impact *and* financial return on invested capital. Several factors have driven the growing popularity of impact investing. In a recent survey, money managers listed client demand, social benefit, and returns as reasons for incorporating social criteria into their investments.³ In short, these investors want to do good and to do well, and they believe that both are attainable.

4. Social Impact Private Equity Funds

The market for private equity funds with a focus on delivering measurable social impact is relatively new, but there are several funds currently operating in the space. Vital Capital Fund is one such example; it is a \$350 million private equity fund investing primarily in sub-Saharan African nations.

One of Vital's current investments is Kora Housing, a \$92 million investment in Angola focused on the construction of 40 000 affordable housing units in 15 new communities across six provinces. The planning was done in consultation with an urban planner, and it also includes necessary infrastructure such as water, sewerage, roads, power grid connection, schools, health centres, and park space. Kora housing is projected to benefit 240,000 people and is currently on track to achieve its projected 18% internal return rate.⁴

South Africa's private equity market has significantly expanded in recent years after a slight post-recession contraction. In 2013 the industry had R162.2 billion under management, which reflects a one-year increase of 17% and a compound annual growth rate of 11.8% over the last fourteen years.⁵ In a 2013 survey conducted by the University of Cape Town's Graduate School of Business, 51% of private equity and venture capital investors reported that they had been investing for impact, while 3% described themselves as impact investors.⁶ This shows both increasing awareness as well as room for growth.

There are currently several South African private equity funds focused on housing investments. Old Mutual Investment Group has an impact investment component called Development Impact Funds. One of its investments is the Housing Impact Fund for South Africa (HIFSA), which is a R9.15 billion investment launched in 2010. The fund seeks to provide investments in the low-income housing sector targeting families earning less than R17 600 per month. It invests in various housing-related investments including physical development, mortgage, and end-user financing, while aiming to achieve the maximum risk-adjusted return for its asset class.⁷

International Housing Solutions (IHS) is a private equity firm focusing on residential housing primarily in the affordable housing market. Its first fund enabled the financing and development of 28 000 homes worth more than R8.6 billion. It

partners with real estate developers, private capital groups, and local government authorities to provide financing for its investments. Since 2012 it has commissioned an outside audit to examine the social impact that its funds have been able to achieve.⁸

5. The Traditional Approach

Traditional efforts to build affordable housing have mostly been of a non-profit nature, such as those undertaken by the government or various NGOs. Habitat for Humanity is one non-profit organisation currently working in housing in South Africa, where it has been actively building since 1996. By the end of 2013 Habitat for Humanity had served more than 3 600 families across 34 communities.⁹

Habitat for Humanity's funding is primarily donor provided. In 2012 its annual revenue was R34.8 million, which was in line with its average revenue for the previous four years. Its beneficiaries are selected based on their monthly income, which has to be less than R3 500, and their willingness to assist in construction. The family then builds the house along with the help of volunteers.

6. Non-Profit Versus For-Profit

The non-profit approach has been effective, and it has its benefits. Whereas for-profit investments are driven at least in part by positive financial returns, non-profits can pursue their strategies without concern over profitability. They are accountable to their donors for the funds they use and they are expected to use them efficiently for the intended purposes, but they are not expected to produce a financial return. They can direct their funds toward beneficiaries regardless of income, ensuring that they reach the most impoverished.

Non-profits are dependent, though, on donors and grants for their operations. Both are finite, and in the case of many non-profits this results in smaller budgets and limited social impact. Habitat for Humanity, for example, constructed approximately 3 600 homes in 27 years, while International Housing Solutions' first fund constructed 28 000 homes over the span of only about five years.

For-profits, such as private equity funds, are often able to raise capital on a much larger scale, thereby achieving greater impact than non-

profits. The size of the private equity funds previously mentioned demonstrates both the scale and the speed with which these types of investments operate. They are, however, constrained by profitability. Because of this, private equity funds invest in housing for people who can afford to buy or rent. These individuals will likely belong to the “gap market”, which consists of those who earn too much to qualify for RDP housing but not enough to qualify for traditional bank mortgages. This is an important segment of the population to serve, but this type of investment does not address the most impoverished.

7. Recent Changes in Private Equity

The affordable housing investment activity of several South African private equity funds is encouraging. The immense scale of the housing shortage, though, calls for greater action. Policy change has already taken place, and it has been effective in encouraging greater investment.

Regulation 28 of the Pension Funds Act of 2011 permitted pension funds to invest up to 10% in private equity; previously they were capped at 2.5%. Greater investment has followed, with the Government Employees Pension Fund committing R5 billion to the South African Private Equity Fund. The Eskom Pension and Provident Fund has recently invested R100 million in IHS's second fund for affordable housing, which it hopes will be even more impactful than its first. Eskom Pension and Provident Fund is also a current participant in HIFSA.

8. Growing Social Impact Private Equity Investment

In order to further stimulate social impact private equity investment, more capital has to be directed towards this asset class. This can be accomplished in several ways.

South Africa needs to increase awareness among investors at home and abroad. The recent trend in impact investing among South African private equity professionals is a good sign, but with only 3% of private equity and venture capital investors

describing themselves as impact investors, there is substantial room for improvement. Raising awareness about investment opportunities in the country is a crucial first step.

Investors are concerned about risk and return, and impact investing often includes greater risk and potentially smaller returns. By incentivizing investments with tax breaks, however, South Africa can motivate investors to put their money to work by lessening the risk they might otherwise face, thereby making impact investing more profitable and more desirable.

The housing shortage and many of the other issues South Africa faces are interrelated, and solving it in isolation without addressing other issues is simply not practical. Related problems like transportation costs, infrastructure, and unemployment will have to be concomitantly addressed. This creates the opportunity, though, to expand investment opportunities for potential private equity funds so that they can diversify their exposure while still committing capital to impact areas in the country.

9. Conclusion

Private equity investment in affordable housing in South Africa will not be a panacea for the housing shortage, but it can play an effective role in helping to lessen it. Private equity is capable of directing large amounts of capital toward impact investments and of effecting change on a large scale. Existing funds have performed well, resulting in the creation of tens of thousands of new homes and delivering positive financial returns to their investors. Expanding this type of investment in South Africa can be instrumental in addressing a housing shortage that is in great need of innovative and expanded solutions.

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¹ Viruly, Francois. "Report on the Second Annual Social Impact Audit of International Housing Solutions Residential Units." 2013.

² World Economic Forum (www.weforum.org/issues/impact-investing)

³ US SIF Foundation (2012): Report on Sustainable and Responsible Investing Trends in the United States.

⁴ Business Wire. "Vital Capital, One of the World's Largest Impact Investing Private Equity Funds, is Highlighted in the World Economic Forum's 'From the Margins to the Mainstream' Report." September 19, 2013.

⁵ "Venture Capital and Private Equity Industry Performance Survey of South Africa Covering the 2013 Calendar Year." KPMG and SAVCA. June, 2014.

⁶ "South Africa Switching On To Investing for Impact." University of Cape Town Graduate School of Business: Newslines. May 10, 2013.

⁷ Old Mutual Investment Group: Housing Impact Fund for South Africa.

(<https://www.oldmutual.co.za/documents/OMIGSA08/Alternative/HIFSAFactsheet.pdf>)

⁸ International Housing Solutions. (<http://www.ihsinvestments.co.za>)

⁹ Habitat for Humanity South Africa 2012 Annual Report.

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