THE JOBS FUND

South Africa Siyasebenza

Learning Series

NO. 2, MARCH 2019

On-Lending for Job Creation in a Low Growth Environment: The Case of TUHF Limited

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The Jobs Fund is a R9 billion fund established by the South African Government in 2011. It was established to encourage innovation and give greater impetus to initiatives with potential to generate sustainable employment. The Fund aims to catalyze innovation in job creation through structured partnerships with the private and public sectors as well as NPOs by awarding once-off grants to organisations through a competitive process. The Jobs Fund operates on challenge fund principles and aims to incentivise innovation and investment in new business approaches that directly contribute to long term sustainable employment creation.

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The Government Technical Advisory Centre, National Treasury

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ABSTRACT

The Jobs Fund (JF) contracted with TUHF Limited (TUHF) in February 2015 to create both new permanent and short term jobs in the three-year funding period. TUHF is an on-lending financial services provider that provides access to finance for entrepreneurs and small and medium enterprises (SMEs) to purchase, and subsequently convert or refurbish buildings in the inner cities of South Africa into affordable residential units for rental. TUHF reported 2,411 new permanent jobs and 5,126 short term jobs by the close of the project in March 2018.

1. INTRODUCTION

TUHF is a specialized financial services company that operates in the niche market of inner-city housing rejuvenation. TUHF's offering is geared towards financing the purchase, construction and management of affordable rental housing by private entrepreneurs in areas marred by urban decline. Entrepreneurs are screened according to their ability to repay loans via a process that uses a combination of individual capabilities and asset yields to determine their creditworthiness. SMEs that access financing from TUHF participate in capability-building initiatives such as training, mentorship and business support that TUHF implements to mitigate investment risk.

As a niche on-lender, TUHF secures market-priced private funding through the issuance of a Domestic Medium-Term Note (DMTN) in capital markets, and passes on their funding costs to the SMEs it finances. The results of the Jobs Fund TUHF project have shown that SMEs associated with the project are perceived to be skilled and well-managed and less of a lending risk. These two outcomes are complementary as an improvement in the skills and management capacity of SMEs can lead to a decrease in the risk of them defaulting on their loans.

TUHF assists with the capacity building and up-skilling of SMEs through training interventions such as the TUHF Programme for Property Entrepreneurs (TPPE) training sessions which are facilitated and accredited by the University of Cape Town. These classes leverage the knowledge of industry experts to educate entrepreneurs on construction-related topics and provide them with practical skills that they can utilise in managing and growing their property businesses.

TUHF received a JF grant of R157.5 million with the agreement that TUHF would match this to the ratio of 4:1. TUHF exceeded this requirement by raising R1.06 billion - a ratio of just more than 6:1 - thanks to the DMTN and the crowding-in of other direct lenders through the balance sheet strengthening mechanism.

2. METHOD AND APPROACH

The evaluation was designed specifically to assess to what extent TUHF had met the two main objectives:

Objective 1: To enhance TUHF's fundraising initiatives from relevant capital providers to stimulate on-lending to SMEs. The aim of the Jobs Fund grant was to attract further lenders to TUHF by providing more security to the funds loaned out by TUHF. This would lead to a decreased level of risk associated with SME on-lenders and funding would become more widely available.

Objective 2: To provide SMEs with access to funding on terms acceptable to them through non-conventional funding models.

The increased security on TUHFs investments meant reduced lending risk and an ability for them to obtain funds at a lower rate. This would enable TUHF to provide loans to SMEs on better terms than they would normally do. This assumes that the rates at which lenders lend to TUHF are based more on the risk associated with TUHF's loan book than external market factors.

Stakeholders were consulted using interviews and Focus Group Discussions to assess their perceptions about the extent to which each element on the Results Chain had been met or not.

The rating scale below was used to assess the extent to which TUHF had met its objectives. The scale was used in conjunction with a colour coded heat map as shown below. The areas shaded in Green were assessed as 'Met" while areas highlighted in Amber were assessed as "Partially Met" and areas shaded in Red were assessed as "Not Met".

Met 67-100%	Partially Met 34-66%	Not Met 0-33%

The percentage in the scale above indicates, for each component of the Results Chains, the weighted average score of all the responses for a particular objective.

Respondents were asked to rate each question according to a five-point Likert Scale. The following Likert Scale was used:

- 1 – Not at all / Strongly Disagree
- 2 – Minimal / Disagree
- 3 – Significantly / Neither Agree nor Disagree
- 4 – Substantially / Agree
- 5 – Extensively / Strongly Agree

3. RESULTS

TUHF has largely been successful in meeting its objectives. The positive results of the TUHF model are most probably due to TUHF's extended experience in the SME lending space. The investors and beneficiaries who were interviewed stated that they view TUHF as the catalyst for funding to inner-city affordable housing developments. TUHF is a good example of an organisation's ability to change market behaviour by convincing other investors to invest in the previously redlined market of inner-city property development.

All intermediate outcomes are perceived to have been met, with the exception of TUHF's "Perceived ability to increase funding at better terms for SMEs", which has been partially met. This may be attributed to the increasing cost of capital incurred by TUHF.

TUHF beneficiaries stated that approximately three staff are permanently employed for every medium to large building that they refurbish. The TUHF Beneficiary Focus Group Discussion revealed that, in a group of five participants, approximately 100 additional jobs were being sustained. Other cases presented, where individuals had unsatisfactory forms of employment or were underemployed prior to their involvement with TUHF, had since been able to improve their employment terms. TUHF beneficiaries report that their standard of living has improved significantly as a direct consequence of their involvement with TUHF.

The majority of TUHF beneficiaries interviewed stated that they had limited or no access to capital prior to TUHF. The high risk of investing in individuals with no historical funding record, limited collateral, and no prior experience in property development, restricts entrepreneurs from traditional funding channels.

Key Insight

"I was a cleaner at Rea Vaya before I joined TUHF."

"Previously I was a policeman, then I started to work with TUHF when I joined AFCO property management, now I own seven buildings."

- Source: TUHF Beneficiary Focus Group

TUHF has opened up financing to individual SMEs who would not have been funded elsewhere, thereby increasing investment in SMEs. In addition, as TUHF operates within the niche-market of inner-city property development, it understands the risks of the inner-city and is able to offer loans to entrepreneurs to purchase, renovate and refurbish buildings in areas typically perceived as unappealing to traditional financiers.

Key Insight

"Entrepreneurs have no other choice without TUHF. The banks will require 30% equity, which is far too much. Banks weren't willing to touch us with the low salaries we had."

"Big banks weren't interested in investing in the inner city especially."

- Source: TUHF Beneficiary Focus Group

TUHF has provided capital to SMEs that lack reasonable alternative funding options. As a result, TUHF is able to establish SMEs that would otherwise not be in business. In addition, TUHF assists struggling SMEs that it recognises as having the potential to succeed. It does this by providing capacity-building interventions, mentorship and additional funding to these SMEs. This is consistent with respondents' perceptions that TUHF has contributed to increased growth in the SME sector over the long-run.

Key Insight

"There is a lot of hand-holding, they work with everyone on every level of sophistication to help you. They have also started a peer-to-peer mentorship. We managed to connect and build relationships."

"TUHF goes over and above to do what other banks would never do for me."

"It [TPPE] made me aware of what I didn't know. They taught us the steps that are necessary to go through before you engage TUHF for assistance. They teach you how to value a property, develop a business plan, and other useful calculations."

– *Source: TUHF Beneficiary Focus Group*

Increased employment has also been noted as an impact of TUHF's involvement with SMEs. The SMEs that TUHF funds help sustain jobs in the short-term through construction activities and create permanent jobs through the employment of building managers.

TUHF reported 2,411 new permanent jobs and 5,126 short term jobs as of March 2018.

4. CONCLUSIONS

TUHF has been successful in creating jobs and appears to have been successful in improving the standard of living of its beneficiaries. Since TUHF's inception in 2003 they have successfully crowded-in investors into the previously untouched space of inner-city affordable housing rejuvenation. They have demonstrated that ensuring entrepreneurs' success by working alongside them is a good way to reduce default risk and build a sustainable funding model.

The JF grant was important in assisting TUHF to secure additional streams of funding from capital markets, thereby enhancing TUHF's ability to finance more entrepreneurs. This has contributed to an increase in employment and an improvement in socio-economic standards. It should be noted that the sector in which TUHF operates is susceptible to fluctuating market conditions, which may squeeze TUHF's profitability in difficult financial periods

It is clear that although large pools of private funding are available in South Africa (e.g. pension funds, life insurance schemes, banks etc.), factors related to SMEs' risk of default due to high business failure rates severely limit their access to these funding sources. On-lending presents an opportunity to facilitate the flow of the much-needed funds from the large pool of capital available to SMEs, who in turn are expected to be the significant contributors to job creation. On-lenders, being intermediaries who know where and how to access finance and how best to deploy these funds by lending to borrowers, can contribute to the funding cycle of SMEs. Thus, on-lenders can exploit their creditworthiness to borrow from lenders and use their niche expertise to extend these funds to SMEs. The access to finance coupled with operational business assistance by the on-lenders can then improve SMEs' chances of success and bring about systemic change in the SME space while creating jobs and contributing to economic growth.

5. BEST PRACTICE RECOMMENDATIONS

5.1 The Market

- It is crucial for on-lenders to identify the specific SME market niche to which it wishes to lend.
- Having an intimate commercial knowledge of the targeted SME market segment helps to optimize the lending options of the on-lender.
- On-lenders need to utilise various platforms to source lending opportunities (e.g. formal ways through credit applications, industry gatherings etc.).

5.2 Operations

- On-lenders should adjust lending practices to the targeted market. Adjustments could include non-traditional ways of assessing credit applications.
- The use of innovative and appropriate risk management practices provide on-lenders with a competitive advantage.
- Providing business support and mentoring to SMEs are forms of risk management and can minimise default rates.

5.3 Funding

- On-lenders need to think broadly about where to source funding. While established on-lenders can source funding from commercial lenders, others should also consider public funding programmes, DFIs, appropriate industrial programmes, capital markets and overseas providers of development finance.
- Diversifying sources of finance can reduce on-lenders' cost of finance.
- Other forms of funding should be considered (e.g. guarantees, subsidised operations, subsidised mentoring etc.). Need to have form and level of funding appropriate to the stage at which the on-lender is in its lifecycle.

5.4 Risk Management

- Risk management should be applied at all critical areas of the business.
- Helping borrowers (SMEs) to formalise their businesses is an important step towards putting them on a profitable growth path.
- Flexible lending terms (e.g. flexible forms and repayment terms can give SMEs space and opportunity to survive and minimise permanent loss of funds through defaults).

5.5 Relationships

Relationships are key. On-lenders should build relationships with current and future borrowers (investees) and funders as well.

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