



**Te Tūāpapa Kura Kāinga**  
Ministry of Housing and Urban Development

# Social housing finance request for information submission summary

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## Context

This document provides a high-level summary of the submissions made during a request for information (RFI) process about ways to improve financing for social housing, run by Te Tūāpapa Kura Kāinga – Ministry of Housing and Urban Development (HUD) in August 2024.

It is being provided to respondents to the RFI and to those who participated in targeted meetings only. HUD takes no view on the accuracy of the statements made by submitters. Inclusion in this document should not be taken as an endorsement by HUD.

## Overview

Financing is typically the biggest component of the ongoing cost of delivering new housing. Many social housing providers have indicated that financing costs and terms are a major barrier to being able to deliver additional supply.

HUD was asked by Ministers Bishop, Potaka and Willis to identify ways to improve Community Housing Providers' (CHPs) access to, and cost of, finance, so they can deliver new supply.

To inform this work, HUD ran a RFI targeted at institutional investors. It was very explicitly not a request for proposals. HUD also held close to 20 targeted meetings with investors.

Ministers are still considering the advice from HUD based on this and other work. On 26 November 2024 Minister Bishop announced the following short-term changes:

- Changes to contracts for new housing supply to make the IRRS revenue stream more attractive for investors and financiers.
- Increased use of leasing to provide social housing, in cases where leasing delivers value for money.
- Capitalising part of the operating supplement (OS) currently paid to CHPs for new housing developments, to be paid upfront when contracts for new social housing are agreed.

Work also continues on:

- options to review standardised risk weights
- options for a credit enhancement intervention for CHPs so that they can access suitable debt.

Further decisions will be communicated to the sector in due course.

# Summary of feedback



## Who we heard from

Source of submission	Number of submissions
Banks	5
Investors	15
Impact investors	5
Intermediary finance/lenders	3
Advisory/Consultancy firms	4
Others	4

## Key issues raised

- There is a lack of long-term government funding certainty, which discourages financiers from investing in the sector.
- The social housing sector faces difficulty in achieving scale, which limits the pool of financiers willing or able to invest.
- A significant lack of available equity, either from the provider's own balance sheet or from other 'patient capital' equity, limits sector capacity.
- The income-related rental subsidy (IRRS) funding stream is unattractive to financiers, because:
  - the current funding approach and levels mean the social housing sector is unable to provide the risk-adjusted returns needed to compete for private sector capital (equity and debt)
  - regulatory constraints (including market rent-based contracting and only being able to pay IRRS/OS to CHPs) impact on the price of finance and limit the range of possible financial arrangements
  - challenges with current contracting and risk allocation, including an 'idiosyncratic risk allocation' and a "set and forget" approach to long-term contracts.

## Suggested options for change

The following were suggested as options for change:

- ten-year investment plans
- clear pipelines for investment in the sector and individual CHPs
- a long-term, stable, HUD toolkit
- changes to IRRS contract terms to make them more appealing to investors
- direct equity (for example, grants or upfront OS) to the sector
- ground leases or preferred land terms to attract private capital in main centres where development economics are better
- increased use of public private partnership (PPP) models
- expansion of build to lease, including the direct lease model
- mixed tenure developments
- refinancing existing debt on properties already in operation and with a good track record
- social impact bonds
- changes to prudential regulations (Reserve Bank of New Zealand settings)
- other interventions to increase KiwiSaver investments in affordable and social housing
- additional regulatory requirements to create different categories of CHP (for example, tier 1, tier 2 etc)
- a new intermediary to provide scale, liquidity and improved credit
- investing/lending via schedule 4A Crown Companies for example, New Zealand Green Investment Finance or Crown Infrastructure Partners
- subordinated debt (for example, OS provided as a loan rather than non-repayable funding)
- interest rate swaps to mitigate interest rate risks (as with PPPs)
- a 'credit enhancement' option such as a government guarantee.

# Response themes



## Barriers for investors in IRRS contracts

### Step-in rights

Investors want:

- clear and systematic procedural framework about how failure to meet obligations will be handled
- the contract to keep going, rather than to foreclose on properties
- more financier direct deeds.

### Termination for convenience in current contracts

- Investors do not think the current compensation regime is sufficient, particularly for build to lease (which is greater of 12-months' rent under lease or remaining term of lease, so effectively capped at 12 months).
- There was significant interest from respondents in the direct leasing structure, where there is no termination for convenience and HUD can change out the CHP.

### Bespoke nature of contracts

- More standardisation is needed to give investors greater certainty.
- There are quite a few bespoke changes and variations to templates that haven't been needed.

### Education and lack of contract simplicity

- There are some education gaps and misunderstandings about how the contracts work.
- CHPs and investors have different levels of understanding and capability.

### Vacancy

- The current allowance for vacancies isn't enough.
- There is more risk of carrying a vacancy in smaller, more remote locations, which isn't recognised.

“No cause termination clause is not commercially palatable. Effectively voids the duration of the lease to the termination period and break cost.”

“There seems to be some difference on every document that we see. Operating Supplements are different, agreement tenors, termination rights, break fees. This results in inconsistent pricing and terms to each transaction and additional work and cost to all parties involved.”

“A no-vacancy guarantee could give comfort that there will not be any cash flow breaks.”



## Scale investors are looking for

### Debt investors

Minimum levels of investment:

The minimum levels of investment vary depending on the institution. For some, minimums varied from \$20–\$50 million. Banks will do smaller deals on a project basis, while boutique financiers will do smaller deals.

Tranches or periods of time:

- Could be done in tranches.
- Investors want scalable templates.

Geographic limits:

- No limits, but some higher risk and difficult economics in regions.
- Golden triangle is easier.

### Equity/impact investors

Minimum levels of investment:

- Significant scale needed.
- Larger scale requires mixed tenure.
- Some impact investors have specific geographic focus.

“It is generally the case that scale, diversification and professional diligence should improve transaction efficiency.”

“We are acutely aware of the position of fund managers and institutional investors, which require significant scale (and also regularity) in investments to warrant the time and costs associated with making such investments.”

“A standardised end-to-end financing process with transparent eligibility criteria is a crucial enabler which can deliver housing where it is needed and contribute scale when aggregated.”

## **Contract terms investors are looking for**

### **Debt: Tenor (noting that amortisation and commitment can be different)**

- Amortisation of 25 years, broken into five-year commitment tranches.
- Some boutique lenders would go further.
- Project finance lenders generally longer term.
- Bonds generally wouldn't be longer than 10 years.

### **Debt: Repayment profile**

- Principal and interest, or interest only.
- Discussion on 'sculpting' of debt and of OS to optimise and minimise repayment risk.

### **Debt: Interest rate risk**

- References to PPP and how they are structured.
- Infrastructure investors want government to take interest rate risk after initial five-year term.
- Investors also noted insurance, rates and maintenance risks. This all gets harder when they go out longer. There is a benefit/risk trade-off.

## **Equity**

- Terms are dependent on who the equity investor is and their holding period.
- Private sector developers and property investors often seek short-run/time-bound gains.
- Institutional investors and other sources of patient capital could be in it for the longer term, but the current funding settings aren't enough to attract them.

## **Funding model investors are looking for**

### **Debt investors**

- Link to property market movements means transactions are classified as property (rather than corporate, infrastructure or residential) and carry the relevant risk profiles/weightings.
- This also leads to lower loan amounts and higher equity requirements.
- Covenants can be very restrictive, especially property covenants – higher debt service coverage ratio and interest coverage ratio, and lower loan-to-value ratio.

### **Equity investors**

- Visibility of pipeline and government commitment – what is the point of committing equity if you can't see the funding stream that will enable you to generate a return?
- Equity from impact investors is time limited and relatively small, a smaller scale option that can work with the current short-term funding packages.

### **Alternative overseas models**

- Availability payments (Australia).

- A cost-based approach – matching the development funding to cost of capital/service and separately paying other costs (for example, tenancy management, rates and insurance).
- Splitting development from operation (for example, leasing arrangements).

## Factors that impact on pricing

### Debt investors

Return parameters:

- Lowest cost form of finance
- Property finance from banks is more expensive than infrastructure and the bond market
- Bank pricing is a function of risk classification, probability of default (PD) and loss given default (LGD)
- Debt is typically priced as a spread over a reference rate (bank bill benchmark rate, official cash rate, five-year swap).

What it would take to lower pricing:

- A more secure long-term pipeline
- Greater scale
- Risk allocation, including timing of commitments (earlier stage)
- Reserve Bank of New Zealand (Reserve Bank) changes.

“It is generally the case that scale, diversification and professional diligence should improve transaction efficiency.”

“Achieving the lowest cost of funds for CHPs is ultimately a function of how much risk the government is willing to remove from the table.”

“The risk profile of the transaction as a whole is considered when assessing appetite for long tenor debt. In general, the more certain the contracted cashflows and the stronger the credit of the off-taker (for example, Government), the more likely [the financier] will have appetite for long tenor debt.”

## Equity

Return parameters:

- More expensive than debt
- Provide double-digit returns (higher returns for a higher risk profile).
- Some environmental, social, and governance (ESG) investors would accept returns under 10 percent (net internal rate of return after fees) but most are above that.

What it would take to lower pricing:

- Develop an asset class
- Debt to equity swap
- More hybrid structures (for example, subordinated debt).

## Environment, social and governance investment

- ESG is a growing area – several banks and investors have specific allocations for it.
- Investors still have a fiduciary obligation to get the best returns for their members, so returns have to be competitive with other assets.
- Infrastructure investors did not see a significant discount for ESG.

“Social housing currently has a property development risk profile and is usually considered to be a property investment. If MHUD can alter the risk profile so investors and financiers consider social housing to be an infrastructure investment, investor return requirements (and social housing projects’ cost of capital) will reduce.”

## Roles each party should play

- CHPs aim to provide a service, and good social outcomes over the longer term. Time horizons are a good match for institutional investors with longer holding periods.
- Institutional capital needs to have an implicit trust in the capability of CHPs to deliver complex and large-scale developments, but CHPs don’t always meet the standard. By the cash going to the CHP, it goes to what some perceive to be the least credit worthy party (between Crown, asset owners/developers and CHP).
- Each CHP and development is a unique credit risk. CHPs have different resources and structures, making assessments challenging. Project-by-project approval processes are inefficient. Strategic partnerships would be more helpful.
- The main issue with regulation is that the funding must be contracted with a CHP. There is ambiguity on the extent to which funding can be assigned to other parties. Most investors would prefer a special purpose vehicle (SPV) structure where lending is to the SPV not the broader CHP entity.
- Insurance issues – there are often disagreements between the asset owners and operators regarding insurance on leasing deals.

“Regulation seems to require IRRS payments to be paid to CHPs only. They cannot be assigned to other parties, such as financiers, which limits available borrowing structures.”

“We do not see any interest or appetite to lend directly to CHPs. We see very significant appetite to invest into non-recourse project finance transactions using SPV structures.”

## Role for intermediaries

There was significant support for intermediaries from respondents with comments that they provide scale, standardisation and due diligence (for bond holders), as transactions are currently labour intensive and being able to ‘outsource’ these to an intermediary would be helpful.

However, some respondents felt that intermediaries are not needed and commented that they add cost and impact headline returns to the investment capital. Some said this depended on how well the roles and responsibilities were understood because investors prefer simplicity.

There were several suggestions for a potential government intermediary or platform for example, government could lend or invest directly via a structure like New Zealand Green Investment Finance or Crown Infrastructure Partners.

“New Zealand is an outlier for not having a government guarantee of the bonds through a specialist intermediary to unlock lower costs and greater scale, by aggregating the sector. This has resulted in higher costs for taxpayers for delivering IRRS contracts.”

“For the CHPs with the most debt, working through a single specialist intermediary is vital, as due to the current size of the CHP sector, a splintered approach to financial markets will limit the appeal and size expectations of financial markets for an asset class. This has been proven domestically through the LGFA.”

“A structure under which a single government department made ‘hell or high water’ payments for social houses direct to financiers would likely attract the lowest bank loan pricing as financiers should be able to ‘look through’ to government credit risk. However, this would require government assuming more risk than under existing structures.”

“All components of a social housing partnership should add direct and sustained value. Layers of intermediaries add cost and impact the headline returns to the investment capital.”

## Development vs long-term ownership/operation

Institutional investors generally don't like development risk – some wanted risk sharing with government in the development phase.

Development lenders and long-term lenders are different:

- Pricing is different – development involves many additional risks. Refinancing risk also needs to be priced for.
- Infrastructure investors like the 'mini perm' structures and phases.
- Once projects are stabilised and there is a track record of income and expenses, there should be more competition for lending.

Some investors don't want to split up development and long-term ownership:

- On the equity side, the aggregation of development margin, long-term commitment and rental income all work together to make the investment attractive and create an aggregated profile that meets investor needs.
- Decoupling the debt is efficient – this is different from decoupling equity.

## Security

- Land is generally taken as security.
- General security agreements depend on the lender.
- Views on leasehold or other alternate structures:
  - Some respondents mentioned potential securitisation of government cash flows, which would remove the need for taking land as security, though this would only work with 'hell or high water' type commitments.
  - PPP structures were mentioned, where 'secondary exit' is secured through the contract.
  - There was repeated reference to the Ngāti Whatua Orakei papakāinga model.
  - Respondents noted that mortgages can be granted over leasehold interests (rather than freehold land).
- One large investor said they would need a government guarantee to make transactions viable if the land is not available as security.

"The PPP model provides a useful example of leasehold lending, under that arrangement secondary exit is secured through the contract (for instance, the Government makes a termination payment to lenders) so market sale is not required."

## Other limitations: Reserve Bank settings

Bank pricing is a function of several factors, including:

- Internal bank ratings
- Risk-weighted asset requirements of the Reserve Bank.

To lower pricing or improve terms, banks would need to show that these loans have lower PD or LGD than other types of loans.

By having the contract refer to 'market rent' it reverts to 'property' risk weighting:

- Anything reflecting property risks is more expensive.
- Income-producing real estate is more expensive than general corporate, which is more expensive than standard residential mortgages (retail lending).
- General corporate, infrastructure, government or residential/retail would all result in lower pricing.

"It would be helpful if the Reserve Bank created a special class of assets for community housing developments with lower capital adequacy requirements to reflect the improved credit quality of the underlying IRRS contracts."

## Other issues and barriers

Other issues and barriers identified by submitters included:

- changing political cycles and lack of long-term funding certainty
- access to and cost of capital:
  - lack of equity (or funding to attract the required returns for equity) is stalling many CHP build to own developments.
  - cheaper debt for CHPs will make the money go further, but it likely won't be enough to get deals across the line.
- current funding parameters which are not sufficient to provide the returns that private sector capital needs (on equity and debt)
- development economics – market value is lower than construction costs in many regional locations. Financing alone can't address this, but access to subsidised land could help get developments across the line in some locations
- HUD timelines and staging of commitments
- high cost of building, which increases the amount of finance needed
- council costs, delays and uncertainties
- insurance costs are also increasing and becoming a more significant barrier
- the current CHP regulatory framework hinders access to capital in some cases, creating obstacles for entities to receive grant funding and creating complex workarounds. This has also limited mixed-tenure developments.

“Equity capital needs to be far more available for the whole social housing sector. This includes affordable rentals, social housing and progressive homeownership housing. Additionally, we need to build communities, not just houses. This means mixed tenure and typology developments so access to equity and debt at reasonable rate needs to be considered across this spectrum.”

“Understanding how the government will use its position to address housing for those most at risk in the short, medium and long term will help us plan accordingly. The absence of this (and 3 to 6-year strategy shifts) makes the sector unpredictable and riskier. This risk is priced in by investors and passed on.”

“At the moment market equity opportunities in social housing are limited to one-off transactions, because of the absence of a stable, coherent and efficient regulatory and sector structure.”