In Confidence

Office of the Minister of Housing

Cabinet Priorities Committee

Market headwinds to residential development and construction: Supporting affordable housing in build-ready developments

Proposal

1 This paper:

1.1 Provides an overview of the growing market headwinds to residential development and construction; their impact on the pace, scale and cost of both public and private sector led housing provision; the risk of a decline in construction activity similar to that seen during the Global Financial Crisis; and the current government responses (both system wide and within the housing and urban development portfolio); and

1.2 Seeks agreement to a targeted and proportionate response, focused on establishing streamlined processes for the government to acquire, or de-risk dwelling sales in, housing developments that could support government housing objectives and priorities with an emphasis on delivery of affordable (including public and transitional) housing. It will focus on developments where house construction has not started and is unlikely to occur in a timely manner (if at all) without government intervention.

2 These new processes will complement the other changes I am proposing to make in the housing and urban development portfolio. Specifically, the proposed changes to KiwiBuild settings to encourage increased delivery of modest new build homes for first home buyers outlined in the accompanying paper *Adjusting the KiwiBuild settings to reflect the current context.*

Relation to government priorities

3 These proposals support a range of Government priorities outlined in the Speech from the Throne, including: reducing homelessness; increasing housing supply, affordability and choice; improving access to home ownership; and improving Māori housing outcomes through collaborative partnerships and home-ownership models.

4 The proposals also support a broad range of strategic objectives and priorities set out in the Government Policy Statement on Housing and Urban Development.

Executive Summary

The impact of the construction market headwinds and existing Government responses

5 The residential development and construction sector is facing a range of growing market headwinds. On the supply side, these include the availability and cost of

building materials, labour and development finance. On the demand side, they include stricter lending criteria, rising interest rates, and declining house price expectations.

6 These headwinds increase the likelihood that, despite record building consents, some sites may not be developed in a timely manner (if at all). This may be because the critical inputs are unavailable, or because the anticipated profit margin is no longer commercially attractive and bankable due to increasing costs and risks, and declining house prices.

7 This Government already has an extensive programme of work in place or under development to address some of the system level barriers to increasing housing supply and affordability. This includes significant investment in trades-training, the Immigration Rebalance, a review of the building consenting system, the Commerce Commission's inquiry into the price of building products, and the Infrastructure Funding and Financing Act. However, it will take time for these initiatives to take full effect. In the shorter term, I am also working with Minister for Building and Construction on plasterboard supply, and the Ministry of Business, Innovation and Employment is consulting on extending the proposed timeline for insulation requirement changes.

8 I expect that some of the supply-side issues will begin to ease over the next 12 to 24 months, as some of our system reforms (e.g. the Immigration Reset) and market responses (e.g. new suppliers and manufacturing facilities) come on-stream. However, sales uncertainty is likely to continue, or increase, with rising interest rates and falling house prices. What I am particularly concerned about is the market delivering less of what we need the most – namely, affordable housing in the places where it is needed. This is an area where the Government can help.

9 I am already proposing to adjust the KiwiBuild Programme settings, in particular the price and income caps, so that the settings reflect the current market context and encourage the increased delivery of modest new build homes for first home buyers.

10 However, there are further targeted opportunities for government to help support demand and deliver affordable housing in the short-term within existing appropriations. This should be a proportionate response to what we are currently seeing in the market. Some housing developments that are yet to commence, and are at risk of being cancelled or deferred due to an increased sales risk, may present timely opportunities for the government to advance its own housing and urban development objectives and priorities, with a particular emphasis on:

10.1 Supporting provision of public and transitional housing, particularly in places where we do not already own land; and

10.2 Increasing the supply of affordable housing for both ownership and rental in the locations where it is needed most[1].

[1] This includes denser housing that is inherently more affordable and critical to achieving a range of social, economic and environmental objectives, as well as subsidised rentals for people who cannot afford to pay a market rent even for a modest home but are ineligible or a low priority for public housing.

11 We already have several existing programmes and funds that we could use to buy and develop land, or support developers and their build partners to develop land themselves through guaranteeing demand so they can secure development finance. What is needed is an approach sitting across these funds and programmes, to help deliver quick decisions for developers with stalled and at-risk developments.

Supporting affordable housing in developments where house building has not commenced

12 To streamline decision-making for developments that are unlikely to progress without government support, I propose establishing a central clearinghouse with expedited decision-making processes. The central clearinghouse will receive and process applications for support of stalled and at-risk developments from developers and house builders. Those projects that meet the criteria for stalled and at-risk developments and could most meaningfully contribute to government objectives and priorities will be rapidly assessed and, if successful, approved for:

12.1.1 acquisition under an existing Government land programme, where the developer wishes to sell the land; or

12.1.2 a Crown commitment to prepurchase or underwrite suitable houses 'off the plans' via a fast-track investment process, where the developer wishes to develop the land themselves, but needs to de-risk sales.

13 The new clearinghouse will be administered by HUD, who will work with Kāinga Ora to ensure it fits with their existing funds and programmes. Land acquisitions will be funded and financed from existing land programme allocations. Pre-purchase agreements and underwrites will be funded by up to $75 million of funding from the Affordable Housing Fund. This will enable successful developers and house builders to meet their financiers' presale requirements, secure development finance and commence construction while the detailed arrangements to finalise the dwellings' end use (e.g. as public housing, affordable rentals or KiwiBuild homes) are being worked through. Funding from other programmes will be drawn on where appropriate to support these end uses, and facilitate recycling of the $75 million.

14 If the applications are unsuccessful, the clearinghouse may refer them to other government programmes as appropriate for 'business as usual' consideration.

The initial focus of this initiative and what it could deliver

15 This proposal is a targeted response that is appropriate and proportionate at this point in time. I propose focusing squarely on developments (or stages of developments[2]) where construction is yet to commence. This will ensure developers, house builders and their financiers are still incentivised to see projects through to completion where construction has already commenced to mitigate their losses. It will also shield the Crown from the liabilities that could accrue from on-selling properties with hidden

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[2] Some developments are completed in clear stages. There may be developments where they have completed all housing within a stage(s) but are unable to proceed to the next stage due to the market headwinds.

faults, due to stressed developers cutting corners or half-built houses having been exposed to the elements while development stalls.

16 It is difficult to quantify how many houses this initiative will deliver because it is highly contingent on the nature of opportunities presented, location specific development economics, and the final tenure mix. However, the prepurchase agreement and underwrites process should support construction of around 250 affordable homes.[3]

Managing expectations and risks

17 Given we can only support a limited number of developments it is important that we appropriately manage expectations and do not waste developers’ and house builders’ time. The publication of criteria defining eligible developments will provide developers with a rapid indication of whether the government is likely to have an interest in their development opportunity. Development opportunities will be assessed against detailed eligibility and assessment criteria to ensure that investment decisions are well targeted (i.e. right house, right place, right price), can be progressed at pace and represent value for money (i.e. the costs and risks are proportionate to the public benefits from a whole of government perspective).

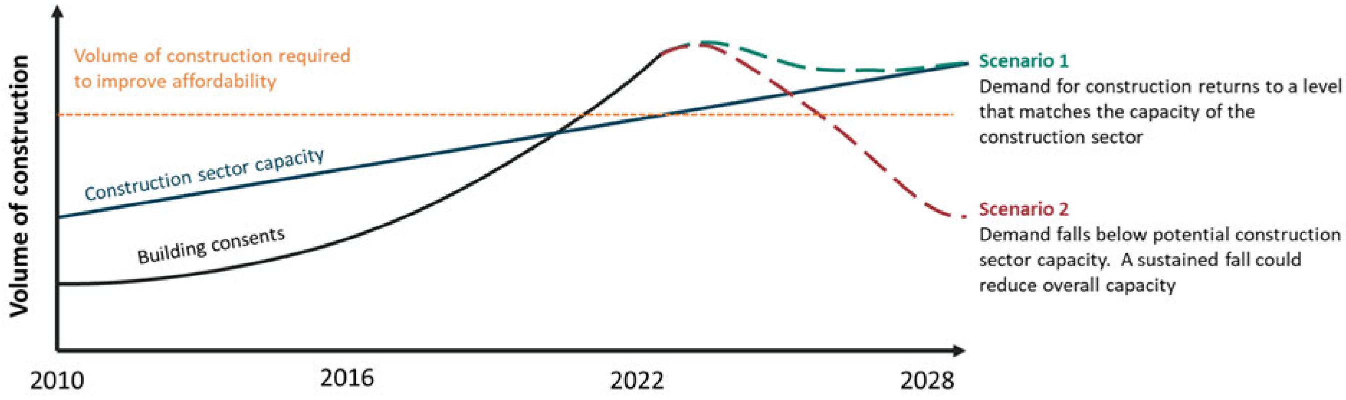
18 Moving at pace will give us the best shot at securing the Government Build Programme’s objectives and ensuring delivery of the types of houses we need most, in the areas with the greatest need. However, this is a careful balance, because in the initial stages these developments will be competing in the current resource-constrained market. That said, we will be focusing on smaller and higher density housing that by its very nature is less resource intensive than large, bespoke houses targeting the upper end of the market, and the proposed level of intervention is also relatively small in scale.

Ongoing monitoring will inform the need for further intervention

19 I intend to continue to actively monitor how the headwinds play out over time. This will provide a clearer picture of whether the market is heading for a soft landing (Scenario 1 below) or a hard landing (Scenario 2 below) and whether additional measures and investments are required to avoid a significant loss of construction sector momentum and jobs.

[3] Depending on the mix of support provided, take-out of housing by other government programmes, and therefore speed that the funding is recycled.

Figure 1: Stylised scenarios for consent volumes and construction activity



20 My key concern is that these headwinds could lead to a drop-off in building activity, particular around the more affordable and denser end of the market, similar to that seen during and after the Global Financial Crisis (GFC). In that case, we experienced an exodus of skills to Australia, and it took the construction sector several years to return to its previous levels of capacity and activity.

21 s 9(2)(g)(i) [redacted]

Background

22 Cabinet originally agreed to establish a $350 million Residential Development Response Fund (RDRF) in 2020 to share some of the costs and risks associated with completing stalled or at-risk developments, due to concerns that the economic impacts of COVID-19 could cause a significant reduction in construction activity and jobs as happened during the Global Financial Crisis [CAB-20-MIN-0328.12 and CAB-20-MIN-0337 refer]. However, the initial economic impact on the construction sector was less severe than anticipated, and the RDRF was not needed for its original purpose at that time.

23 In March 2021, in response to rising prices, it was announced that the emphasis of the RDRF (now called the Affordable Housing Fund (AHF)) would shift from supporting construction activity and jobs to supporting the delivery of more affordable housing options for rent and homeownership. Cabinet agreed to the design of the refocused Fund in December 2021, delegating implementation decisions to the Ministers of Finance and Housing [SWC-21-MIN-0228]. Further amendments to the nature of the funding to better support the new affordability focus through explicit subsidies, where needed, were made through Budget 2022.

24 The Minister of Housing has announced an initial funding round of up to $50 million in grants to support delivery of affordable rentals by not-for-profit providers targeting lower income households in six areas of high need.[4] This briefing proposes establishing a second $75 million fast-track delivery channel under the AHF that will increase the supply of affordable housing by supporting the completion of stalled or at-risk developments. This reflects the fact that the market is changing, and now dealing with a mix of both growing headwinds to residential development and construction and declining housing affordability (due to rising rents and interest rates, and tighter lending criteria).

Growing market headwinds risk the level of construction falling below what is required to improve housing supply and affordability

25 Despite record building consents, the residential development and construction sector is facing a range of growing market headwinds including on the:

25.1 **Supply side:** the limited availability and rising cost of building materials, labour, and development finance; increased consenting timeframes; and reduced productivity (due to delays and illness**)**

25.2 **Demand side:** rising mortgage interest rates; tighter lending criteria; uncertain population growth; and declining house price expectations

26 New dwelling construction inflation was 18.3 per cent in the year to March 2022, and alongside food and petrol, was a major driver in the headline CPI inflation of 6.9 per cent, according to Stats NZ who survey over 120 builders each quarter. Anecdotal

[4] Auckland, Tauranga-Western Bay, Rotorua, Napier-Hastings, Wellington, and Nelson-Tasman

evidence suggest that typical house construction timeframes have increased by around 3 months.

27 The Official Cash Rate (OCR) has increased from .25 per cent to 2 per cent, and is forecast to peak at 3.9 per cent in June 2023. While economists are predicting house prices to fall by around 20 per cent in real terms from their November 2021 peak, rising costs and longstanding underlying housing shortages continue to place upwards pressure on private rents and demand for public housing.[5]

28 Collectively, these factors increase the likelihood that a higher than usual proportion of developments will not commence in a timely manner, if at all. This may be because the developers and house builders are unable to secure critical inputs and/or the anticipated development margin is no longer commercially attractive due to the increased costs and risks, and declining house prices. The Government Build Programme is likely to also face increased costs and delays that will impact delivery of public, transitional and affordable housing.

29 Based on feedback from the sector, we can expect that most projects that have already commenced will be completed, because developers, house builders and their financiers have strong incentives to complete developments that have already commenced to recoup their investment. However, we should expect, and are already seeing, some developers and house builders fail part way through a development. In most cases, we can expect that someone else will be prepared to purchase (through the liquidation process, and at the right price) and complete these developments.

30 Developers and house builders with projects or stages that are yet to commence will face a range of choices. Those who are no longer able to secure development finance, or are unhappy with the anticipated returns relative to the costs and risks, may choose to on-sell their land or land bank and ride out the cycle. This would be particularly problematic in locations already facing constrained land supply, such as Tauranga. Other developers and house builders with strong balance sheets, well established supply chains and efficient delivery models may still choose to proceed. However, over time we can expect total consents volumes to slow in response to declining project viability.

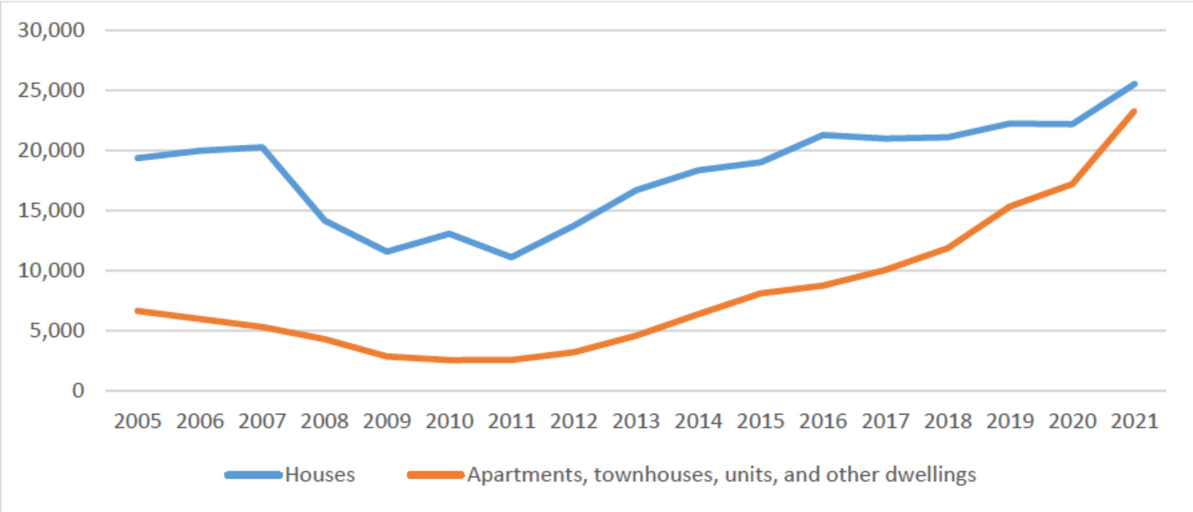
31 Some of this adjustment is necessary to bring consent volumes more into line with sector capacity (Scenario 1 in figure 1, page 4). However, the key risk is that supply falls below both the sectors' capacity (with consequential job losses and scarring) and the level of construction required to reduce the housing shortage and improve affordability (Scenario 2 in figure 1). We know from previous boom-bust cycles that the sector is quick to shed workers (e.g. to Australia or other sectors) and companies during downturns, and slow to rebuild capacity and capability when demand for construction workers returns.

32 During the GFC, the availability development finance and the number of people willing and able to purchase housing declined significantly, even as underlying

[5] The Stats NZ Rental Price Index increased by 6.9 percent in the year to April 2022. There were 26,868 applicants on the Housing Register as at 31 March 2022, an increase of 13.4 percent from the same time last year.

demand for housing remained strong. As a result, between 2008 and 2011 house-building declined by approximately 50 per cent and the residential construction sector lost approximately 25 to 30 per cent of its workforce. It took seven years for the construction sector to regain the same number of employees it had in 2007, and close to ten years post-GFC for the sector to get close to building enough houses to match underlying demand (using a crude aggregate measure).

Figure 2: Building consent numbers before, during and after the Global Financial Crisis



33 While the drivers of the GFC were different to the current situation, the resulting impact on the residential construction sector from the current headwinds could be similar in effect.

34 Additionally, there is a risk that any downturn in construction activity will disproportionately impact the types of housing that we need most, including:

34.1 Medium and higher density developments that are harder to stage to manage the development and sales risks, but critical to achieving our broader wellbeing social, economic and environmental objectives. Figure 2 above shows the disproportionate downturn in density seen during the GFC

34.2 Housing in regional locations with unmet housing needs and sharply rising rents, but low per capita construction activity due to marginal development economics.

34.3 Affordable housing for both ownership and rental.

35 A more comprehensive overview of the market headwinds and response is provided in Annex A. It reflects a mix of insights gathered from HUD's regular engagement with suppliers, financiers, developers, house builders and quantity surveyors and others; themes from the first biannual construction sector round table; key data; and expert analysis.

We already have an extensive work programme underway to address the underlying system challenges, but it will take time

36 Many of the challenges the sector currently faces relate to global factors, commercial decisions, and individual household decisions over which the Government has limited control. In other cases, they relate to long standing issues with the residential development and construction system that have been exacerbated by Covid-19 (including the introduction and unwinding of monetary stimulus).

37 We already have an extensive range of system level initiatives, spanning multiple portfolios, in place or under development that will help to boost sector capacity, support demand for new housing, and remove unnecessary barriers to residential development and construction. These are listed in Annex B and include:

Availability and costs of building materials

37.1 **The Commerce Commission's inquiry into the price of building products.** This study commenced in December 2021 and is considering industry structure, the nature of competition, and barriers to the entry or expansion of new or innovative building supplies. The final report is due in December 2022.

37.2 **Supply chain logistics.** An All-of-Government supply chain monitoring group is meeting fortnightly, and reporting monthly, on international and domestic supply chains. Supply chain bottlenecks are expected to start easing in 2023 and 2024 as new freight capacity comes on stream and the immediate impact of Covid-19 begins to recede. The Ministry of Transport is currently consulting on an issues paper on the future of New Zealand's freight and supply chain strategy, with a focus on resilience and climate change adaptation.

37.3 **Insulation standards and product substitutions.** In response to sector feedback, officials are also investigating whether the new insulation standards due to commence in November should be deferred due to supply constraints, and whether any more immediate steps could be taken to better support product substitutions (with an emphasis on plasterboard, given the significant wait time for GIB which currently has around 95 percent of market share).

Access to skilled labour

37.4 **The Immigration Rebalance.** Borders will fully open from 31 July, and the Immigration Rebalance will make it easier to hire high-skilled migrants with the introduction of a medium wage threshold for most Accredited Employer Work Visas. Simplified application and residence pathways will be introduced for hard-to-fill occupations, including construction project managers, project builders, quantity surveyors, engineers, plumbers and electricians. A construction sector agreement to be implemented in late 2022 will provide exceptions to the median wage requirement for specified construction sector roles where migrant labour is needed, with lower wage thresholds in place for some roles until the sector agreement is in place.

37.5 **Increased support for trades training** Apprenticeship Boost has supported over 43,000 apprentices since it began in August 2020 as a COVID-19 Response. Additional Budget 2022 funding will help another 24,000 apprentices to start getting Apprenticeship Boost support and some 14,000 to keep being supported beyond August 2022, when the initiative was meant to conclude. Budget 2022 will also fund 1,600 additional places in Mana in Mahi over the next two years and extend funding for Māori Trades Training.

Consenting

37.1 **MBIE's Review of the Building Consenting System.** This review will consider issues identified with the current system including poorly defined roles and responsibilities, regulatory settings that may discourage innovation, and issues with the volume and quality of documentation that add time and cost to the building process. Preferred options will be presented to the Minster for Building and Construction in [redacted] s 9(2)(f).

Financial incentives

37.2 **Financial incentives to redirect property investment into new supply.** The phased removal of interest deductibility on residential investment properties incudes a 20-year exemption for new builds. New build investors are also subject to a reduced bright line test on capital gains (five years versus ten), and exempt from the Reserve Bank's Loan to Value (LVR) restrictions.[6]

38 I expect that some of the supply-side issues the sector is facing will begin to ease over the next 12 to 24 months as these initiatives take full effect, and market led initiatives (e.g. new suppliers and manufacturing facilities) come on-stream. However, on their own, these initiatives are unlikely to deliver sufficient incentives for the market to adequately address the unmet housing needs and aspirations of low-to-moderate income households.

Some cancelled or deferred developments may present more direct and timely opportunities to advance our housing and urban development objectives and priorities

39 Some cancelled or deferred developments may present more direct and timely opportunities for the Government to advance its housing and urban development objectives and priorities, with a particular focus on:

39.1 Supporting provision of public and transitional housing, particularly where we do not already own suitable land; and

[6] LVR lending restrictions are tighter for non-exempt loans secured by investment property. New loans with less than a 40 percent deposit can make up no more than 5% of a bank's total new lending in this category. This compares to a 20 percent deposit requirement (and the same 5% threshold) for non-exempt owner-occupier loans.

39.2 Increasing the supply of affordable housing for both ownership and rental, including higher density housing that is inherently more affordable by virtue of its modest design and efficient land and infrastructure use.

Our current tools could help……

40 We already have a range of programmes and funds (these are summarised in Annex B) that we could use to:

40.1 Purchase and facilitate development of suitable land ourselves; or

40.2 Commit to purchasing (or support others to commit to purchasing) or underwriting the sale of houses, where increased sales risk is the primary barrier to developers securing development finance and completing developments themselves.

41 In particular, there is a need for the KiwiBuild programme to play an increasing role in maintaining the supply of modest, inherently more affordable new builds. The accompanying paper *Adjusting the KiwiBuild settings to reflect the current context* seeks Cabinet's approval to increase the KiwiBuild price and income caps (while maintaining a strong focus on first home buyers) to restore commercial viability Together with the recent changes to first home buyer support settings announced as part of Budget 2022[7]and our Progressive Home Ownership Fund, adjusting KiwiBuild settings will reinforce our commitment to making homeownership more accessible.

…but there is scope for a faster, more efficient process on top

42 What is also needed is an approach sitting across these funds and programmes, to help deliver quick decisions for developers where necessary. Speed is particularly important. when developers' and house builders' balance sheets are already under pressure from increased costs, risks and delays.

Establishing a new central clearinghouse with expedited decision-making processes

43 To streamline decision making for stalled or at-risk developments that are complex or time sensitive and are unlikely to progress without Government support, I proposed establishing a central clearinghouse with expedited decision-making processes.

Overarching objectives and investment principles

44 The primary objectives of the central clearinghouse will be to increase the supply of public, transitional and affordable housing where it is needed most, by supporting suitable stalled or at-risk developments to deliver housing.

45 Supporting objectives include:

[7] This included changes to income caps, increasing the house price caps for First Home Grants and Kāinga Whenua Loans, and removing house price caps altogether for First Home Loans

45.1 Maintaining construction sector capacity and capability and

45.2 Supporting the Government's broader objectives and priorities for housing and urban development**.**

46 I propose that the detailed design and implementation of the new clearinghouse process are guided by the following investment principles:

46.1 **Strategic** – investment decisions should reflect Government's strategic direction and priorities for housing and urban development as set out in the Government Policy Statement-Urban Development, MAIHI Ka Ora – the National Māori Housing Strategy, and relevant accountability documents.[8]

46.2 **Targeted** – investment decisions should reflect local housing needs and aspirations as identified through the Public Housing Plan, place-based partnerships and housing heatmaps; and focus on the locations, typologies and cohorts that are unlikely to be commercially attractive absent government intervention

46.3 **Transparent** – the process for identifying and prioritising projects, and the type and quantum of Government investment in projects, should be fair and transparent.

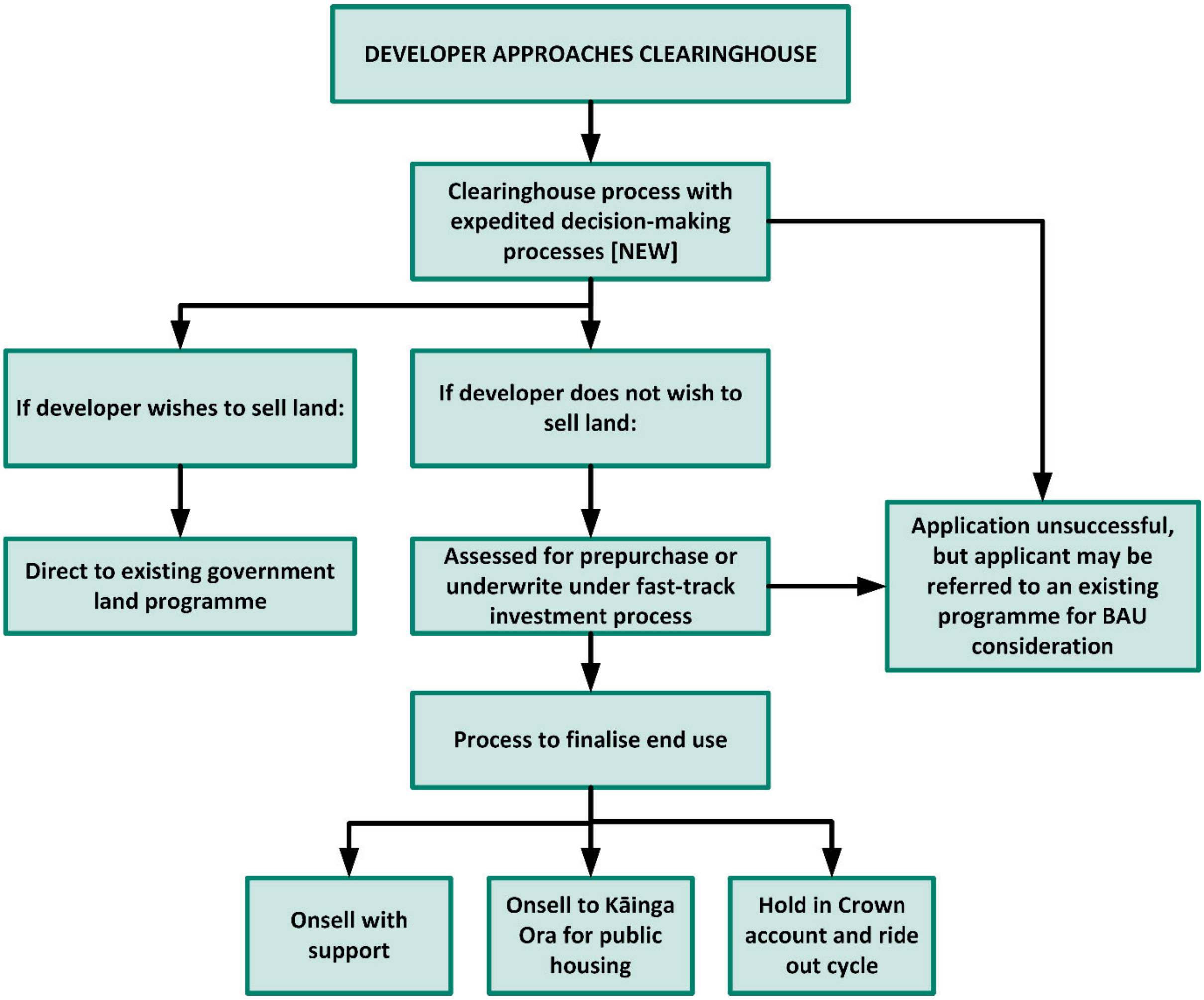
46.4 **Value for money** – the Government's cost and risks exposure should be proportionate to the public benefits, from a whole of government viewpoint, and the risk of moral hazard avoided**.**

Process overview

47 The following diagram provides a high-level overview of how the proposed clearinghouse process will work. A more comprehensive overview with key decision points is provided in Annex C.

[8] For example, letters of expectations.

Figure 3: Simplified overview of proposed clearinghouse process



48 The clearinghouse will receive and process applications from developers and house builders wishing to sell or seek Government support to progress consented developments that are unlikely to be built without government assistance. Projects will be rapidly assessed to determine which projects meet the minimum eligibility criteria and can most meaningfully contribute to government objectives and priorities.

49 Successful projects will either:

49.1 be acquired under an existing Government land programme, where the developer wishes to sell the land (subject to any consequential amendments necessary to reflect the unique nature of stalled or at-risk developments)[9]; or

49.2 receive a prepurchase commitment or sales underwrite from the Crown for suitable houses 'off the plans' via the new fast-track investment process,

[9] This includes HUD's Land for Housing Programme, the Kāinga Ora land Programme and routine land purchases for the construction of Kāinga Ora owned Public Housing.

where the developer wishes to develop the land themselves, but needs to de-risk sales.

50 The new clearinghouse process will be administered by HUD, with support from Kāinga Ora where appropriate. Land acquisitions will be funded and financed from existing land programme allocations. Pre-purchase agreements and underwrites will be funded by up to $75 million of funding from the Affordable Housing Fund.

Advantages of the clearinghouse process

51 Where underwrites or prepurchase agreements are agreed, this will enable the developer to meet their financier's pre-sale requirements and get on with house construction while the details to finalise the dwellings' end use once completed are worked through and finalised. This will be particularly helpful for sites that are suitable for a range of tenures of housing, which can be particularly challenging to secure support for in short timeframes, given the need to coordinate multiple delivery partners and navigate multiple procurement process to secure the required support from government.[10]

52 On completion there are a number of possibilities for the end use of houses, depending on the specific market conditions, the nature of the development and nature of unmet housing needs in that location:

52.1 On-selling homes to first home buyers in accordance with the standard KiwiBuild eligibility criteria (potentially in conjunction with a First Home Grant, First Home Loan, or via the First Home Partner shared equity scheme)

52.2 On-selling homes to Community Housing Providers or Māori housing providers for:

52.2.1 Use as transitional housing, public housing or affordable rentals; or

52.2.2 On-sale via the providers' own progressive home-ownership scheme; or

52.3 On-selling homes to Kāinga Ora for use as public or transitional housing; or

52.4 Retaining homes in the name of the Crown and renting (either directly or via a community housing provider (CHP)) as transitional, public or affordable housing.

53 These acquisitions and underwrites are not without risk. While the aim is to recycle as much as possible (including mitigating losses where we can by requiring developers

[10] For example, in order to meet a bank's presale requirements a developer may have to apply for and negotiate a KiwiBuild underwrite, and at the same time negotiate sale and purchase agreements with one or more Community Housing Providers whose ability to purchase the completed homes will in turn be contingent on applying and being approved for the Income Related Rent Subsidy and Operating Subsidy, an AHF grant, and a Progressive Home Ownership loan to deliver a mix of public housing, affordable rentals and progressive home ownership in the development. These contingent negotiations can take many months, with any delay or inability to secure funding for any single component potentially jeopardising the whole development.

to absorb some of the costs through lower margins), some houses may be on-sold at a loss to the Crown. This may be due to changing market conditions or because the end use requires an explicit subsidy (e.g. so that a CHP can charge a below market rent and still service their ongoings). These risks and costs are the very reasons why government intervention is needed.

54 The on-sale process will be supported by existing sources of funding and financing where practicable, including Kāinga Ora debt headroom and dedicated funding for public, transitional, and affordable housing. This will facilitate rapid recycling of the $75 million. Retaining homes in Crown ownership would likely be reserved for situations where a suitable end purchaser cannot be found, or market conditions mean it makes more sense for the Government to retain the properties and wait for the market to recover rather than on-selling them at a significant loss.

Indicative eligibility and assessment criteria for pre-purchase commitments and underwrites

55 Throughout the process, it will be important to appropriately manage expectations and ensure rapid decision making. We cannot save every development, nor would we want to; and it is important that we do not waste developers' time.

56 Proposals that meet the initial eligibility requirement and could feasibly contribute to Government's objectives and priorities will be subject to more thorough due diligence and assessment by a suitably qualified panel. Applicants will need provide evidence from a prospective financier that they are willing and able to advance finance for the project, subject to securing the required presale or underwriting commitments from the Crown.

57 The assessment process will include consideration and prioritisation against set eligibility and assessment criteria to ensure that investment decisions are well targeted, developments can be progressed at pace and the Government's cost and risk exposure is proportionate to the benefits. Indicative high-level eligibility and assessment criteria are set out in Annex D. I am seeking delegated authority for the Ministers of Finance and I to agree the final criteria, following further targeted engagement with sector experts and representatives.

58 In some cases, we may need to underwrite open market housing to secure public and affordable housing within mixed developments. While this will not be a focus, it reflects the fact that these projects will already be in the advanced stages of planning and consenting, with limited scope to amend the plans to incorporate a higher proportion of more affordable dwellings; and financiers are requiring a greater overall proportion of presale commitments in the current environment.

59 I do not recommend providing support for the completion of partially built houses, as this would reduce the incentives for developers and/or their financiers or receivers to see projects through to completion to mitigate their losses. It would also expose the Crown to potential liabilities that could accrue from on-selling properties with latent defects due to stressed developers cutting corners or half-built houses having been exposed to the elements.

Indicative criteria to support on-sale decisions

60 Relevant factors for deciding the appropriate end use of dwellings acquired or underwritten will indicatively include:

60.1 Joint Minister's priorities regarding the tenure split (public housing, affordable rentals, etc)

60.2 The nature and composition of unmet housing demand in that place and the suitability of the dwellings to meet that demand

60.3 The extent to which it would enable capital recycling into new properties, and the non-recyclable cost to the Crown

60.4 The capacity and capability of housing providers in the area who we may wish to manage/on-sell properties to.

61 On-selling to CHPs and Māori housing providers will likely be a high priority, as this is most consistent with the overarching purpose of the AHF.

Delegations to joint Ministers

62 Due to the importance of acting at pace and retaining flexibility in a fast moving and dynamic environment, I propose that all matters relating to the detailed design and implementation of the new clearinghouse are delegated to the Ministers of Finance and Housing. This includes:

62.1 Detailed eligibility and assessment criteria

62.2 Geographic targeting

62.3 Which houses, or types of houses, may be acquired or underwritten

62.4 End use/on-sale decisions

62.5 Contract terms

62.6 Any matters that would usually require Cabinet consideration in accordance with CO (19) 6

62.7 Any other matters that are reasonably necessary to give effect to the policy objectives and intent, including any consequential amendments to existing housing funds and programmes (e.g. in relation to procurement processes and design standards)

62.8 Subdelegating decision making to officials, where appropriate.

Financial Implications

63 I am seeking agreement to use up to $75 million of the Affordable Housing Fund non-departmental output expense multi-year appropriation (MYA) for the fast-track investment process. This will be used as follows:

63.1 $65 million will be used to underwrite developments; to cover the acquisition of developments if required, with the intention to on-sell them.

63.2 the residual $10 million will be used for costs such as holding costs, write downs and loss on sale.

64 The sale proceeds from third parties up to $65 million from on-selling the purchase of the underwritten developments can be used to increase the Affordable Housing Fund non-departmental output expense MYA.

65 The acquisition of developments with the intention to on sell will be treated as inventory, so at the time of sale an expense is recognised which is expected to be offset with a corresponding revenue.

66 Overall, the purchasing of underwritten developments is not expected to impact the operating balance and net debt.

67 Operational costs, including staffing, overheads, due diligence costs, expert advice etc will be funded via departmental appropriations. This can be partially or wholly drawn from the departmental AHF funding of $2 million per annum.

Implementation

68 Subject to Cabinet endorsing the recommendation in this paper, I am aiming to launch the clearinghouse from August 2022.

69 The detailed design and implementation will be informed by HUD's ongoing engagement with the sector and monitoring of key indicators. This is expected to include some initial engagement with financiers who are well placed to identify prospective developments that could contribute to the Government's housing objectives and priorities, but are unlikely to progress without government intervention in the current environment.

70 The number of houses supported through the clearinghouse process will be highly contingent on the nature of the opportunities presented, location specific development economics, and the final tenure mix. My conservative estimate is that the clearinghouse process should support delivery of at least 250 public, transitional and affordable homes, depending on the mix of pre-purchase agreements and underwrites and rate of capital recycling.

71 The Minister of Finance and I will receive regular updates on the delivery pipeline, which will also be reflected in the monthly updates to the Government Housing Dashboard.[11] s 9(2)(f)(iv) [redacted]

[11] The Government Housing Dashboard | Te Tūāpapa Kura Kāinga - Ministry of Housing and Urban Development (hud.govt nz)

Legislative Implications

72 There are no legislative implications arising from this paper.

Population Implications

73 The proposals outlined in this paper aim to increase the supply of transitional housing, public housing and affordable housing (for both ownership and rental) where it is most needed. As such, they are expected to benefit:

73.1 Those members of the population who are most likely to rate their housing as unaffordable, including Māori and Pacific peoples, sole parents, recent migrants, low-income earners, non-owner-occupiers, the unemployed, and disabled people.

73.2 In particular, Māori and Pacific people are more likely to experience severe housing deprivation; live in damp, mouldy or crowded housing; live in public housing; and are less likely to own their own homes, than the general population.[12]

Consultation

74 MBIE, Kāinga Ora and Treasury were consulted. DPMC was informed.

75 The recommendations in this briefing have also been informed by HUD's ongoing engagement with a diverse range of market participants and experts, including large and small firms, industry bodies, iwi/Māori developers, build to rent providers and community housing providers, working both with the Crown and independently.

Communications

76 I will work with officials to develop a communications and engagement approach to launching the clearing house and engaging with stakeholders in the residential construction sector.

77 I will look for opportunities to connect the announcement of the clearing house to other initiatives targeting at countering market headwinds for example, updates to KiwiBuild policy settings.

Proactive Release

78 The Minister of Housing intends to proactively release this paper within 30 days of Cabinet agreement, subject to any redactions that may be reasonably necessary to preserve the Crown's negotiation position in relation to the acquisition and end use of properties acquired through the new clearinghouse process.

[12] Source: Stats NZ (2020). Housing in Aotearoa: 2020. Retrieved from www.stats.govt.nz. ISBN 978-1-99-003226-4 (online) Published in December 2020 by Stats NZ Tatauranga Aotearoa Wellington, New Zealand

Appendices

- Annex A: Overview of the current market headwinds and how they may impact the sector
- Annex B: Current Government initiatives to support housing supply and affordability
- Annex C: Overview of the proposed clearinghouse process
- Annex D: Indicative eligibility and assessment criteria for the clearinghouse process

Recommendations

79 The Minister of Housing recommends that the Committee:

1 **note** that the growing headwinds to residential development and construction increase the likelihood of some housing developments being deferred or discontinued either:

1.1 Because the critical inputs (e.g. labour and materials) are unavailable; or

1.2 The anticipated profit margin is no longer commercially attractive due to increasing development costs and risks, and declining house price expectations making it hard to secure finance

2 **note** that some cancelled or deferred developments may present opportunities for the Government to advance its own housing and urban development objectives and priorities

3 **note** that we have a range of existing tools that we could use to acquire and develop, or de-risk the sale of dwellings in, stalled or at-risk developments, but there is opportunity to do more

4 **agree** to establish a new clearinghouse process to receive and assess approaches from developers wishing to sell land or seek Government support to progress developments that are unlikely to be built without government assistance, and refer proposals that meet relevant criteria to either an existing government land programme or consideration for a prepurchase or underwrite decision

5 **agree** to establish a new fast-track investment process under which the Crown may commit to purchasing (or underwriting the sale of) suitable houses ‘off the plans’, so that developers wanting to develop their own land can meet their financiers’ presale requirements and commence construction while the detailed arrangements to finalise the dwellings’ end use (e.g. as public housing, affordable rentals or first homes) are being worked through with other government funds and programmes

6 **agree** that the primary objectives of the new clearinghouse process is to increase the supply of public, transitional and affordable housing (for both ownership and rental) where it is needed most

7 **agree** that the supporting objectives of the new clearinghouse process are to:

7.1 support the Government's broader objective and priorities for housing and urban development; and

7.2 maintain construction sector capacity and capability

8 **agree** that detailed design and implementation of the new clearinghouse process are guided by the following investment principles**:**

8.1 Strategic (e.g. investment decisions should reflect the Government's strategic objectives and priorities under the GPS-HUD)

8.2 Targeted (e.g. investment decisions should reflect local housing needs and aspirations, and focus on gaps the market is unlikely to fill without government intervention)

8.3 Transparent (e.g. processes and investment decisions should be fair and transparent)

8.4 Value for money (e.g. the Government's costs and risk exposure should be proportionate to the benefits)

9 **Authorise** the Ministers of Finance and Housing to determine all matters relating to the detailed design and implementation of the new clearinghouse process, including:

9.1 Detailed eligibility and assessment criteria

9.2 Geographic targeting

9.3 Which houses, or types of houses, may be acquired or underwritten

9.4 End use/on-sale decisions

9.5 Contract terms

9.6 Any matters that would usually require Cabinet consideration in accordance with CO (19) 6

9.7 Any other matters that are reasonably necessary give effect to the policy objectives and intent, including any consequential amendments to existing housing funds and programmes (e.g. in relation to procurement processes and design standards)

9.8 Subdelegating decision making to officials, where appropriate

10 **agree** to use up to $75 million of the Affordable Housing Fund non-departmental output expense multi-year appropriation (MYA) for the fast-track investment process, as follows:

10.1 $65 million to underwrite developments; to cover the acquisition of developments if required, with the intention to on-sell them.

10.2 the residual $10 million for costs such as holding costs, write downs and loss on sale.

11 **agree** that once proceeds are received from third parties, up to $75 million from on-selling the purchase of the underwritten developments can be used to increase the Affordable Housing Fund non-departmental output expense MYA.

12 **authorise** the Minister of Finance and Minister of Housing to increase the Affordable Housing Fund non-departmental output expense MYA on the basis that the Ministry will receive proceeds from third parties.

13 **agree** to establish a new revenue class as follows for the sales of the underwritten properties to third-parties:

Title	**Type**	**Scope**
Sale of Developments Underwritten	Non-Tax Revenue	Funding received from the sale of developments underwritten.

14 **note** the indicative profile of sale proceeds is expected to be as follows, with a corresponding impact on the operating balance and net debt:

	$m – increase/(decrease)				
Vote Housing and Urban Development **Minister of Housing**	**2021/22**	**2022/23**	**2023/24**	**2024/25**	**2025/26 & Outyears**
Non-Tax Revenue: Sale of Developments Underwritten	-	32.5	32.5	-	-

15 **note** that consenting to the policy change above, means agreement to acquire inventory which will be recognised as an expense and therefore requires an appropriation once on-sold to third parties, which will be offset by proceeds on sales from third parties noted in recommendation 14.

16 **note** that the Minister of Finance and the Minister of Housing have agreed to add the following category to the multi-category appropriation "Housing Programme Fair Value Impairment Loss and Inventory Disposal" [BRF21/22041300 refers]:

Title	**Type**	**Scope**
Sale of Developments Underwritten - Costs	Non-departmental Other Expense	This category is limited to the expenses incurred as part of the sale of underwritten developments incurred under the Supporting Stalled and At-Risk Developments Scheme.

17 **approve** the following changes to appropriations to provide for sale of developments underwritten - costs, with a corresponding impact on the operating balance and net debt:

	$m – increase/(decrease)				
Vote Housing and Urban Development Minister of Housing	**2021/22**	**2022/23**	**2023/24**	**2024/25**	**2025/26 & Outyears**
Multi-Category Expenses and Capital Expenditure: Housing Programme Fair Value Impairment Loss and Inventory Disposal Non-departmental Other Expense: Sale of Developments Underwritten - Costs	-	32.5	32.5	-	-

18 **agree** that the proposed change to appropriations for 2022/23 above be included in the 2022/23 Supplementary Estimates and that, in the interim, the increase and any expenses incurred against the new category be met from Imprest Supply

19 **note** that the Ministers of Finance and Housing will receive regular updates on the progress of applications through the clearing house and the delivery pipeline.

….

Authorised for lodgement

Hon Dr Megan Woods

Minister of Housing

Annex A: Overview of the current market headwinds, including their current and potential future impact

80 On the supply side, the key headwinds relate to the availability and cost of:

80.1 **Building materials.** Shortages of key materials (e.g. structural timber, cladding and plasterboard) are affecting the scheduling of sub-trades, reducing productivity and delaying completions. There are also reports that uncertainty about the availability of construction materials has led to an increase in stockpiling, mainly by larger businesses with deeper reserves and more buying power. The EBOSS Quarter 1 2022 Construction Supply Chain Report reported that the average price increases to customers (between August 2021 to January 2022) had been: 20 per cent on structure, 16 per cent on enclosure, 19 per cent on interior, 15 per cent on finish, and 15 per cent on other construction material categories

80.2 **Labour supply and productivity.** Current consent volumes exceed labour capacity, which until recently has also been impacted by closed borders and site shutdowns adversely impacting productivity. Construction industry wages increased 3.2 percent in the year to March 2022 (according to Stats NZ's Labour Cost Index), and competition for available workers is intense. While the barriers to importing skilled labour are expected to ease as international borders reopen, there are concerns that this could also facilitate an exodus of existing workers to other countries offering higher wages and cheaper living costs, as happened following the Global Financial Crisis.

80.3 **Development finance.** Banks are reportedly becoming increasingly cautious with respect to development lending, focussing on larger developers with stronger balance sheets and cash-flows, and more experience dealing with market downturns. Banks and other financiers are also seeking increased proportions and certainty of presales before advancing development finance. While total bank lending for development has increased from its immediate post-Covid lows, it is still around 20 percent lower than pre-Covid levels

81 New dwelling construction inflation was 18.3% in the year to March 2022, and along with food and petrol, was a major driver in the headline CPI inflation of 6.9%, according to Stats NZ who survey over 120 builders each quarter. Estimates of the aggregate impact on construction costs vary. In addition to the factors outlined above, many councils across the country are struggling to process building consents within the 20-working day statutory timeframe – creating further uncertainty, delays and costs.

82 On the demand side, the key headwinds include:

82.1 **Lending criteria.** While new build mortgages are exempt from Loan to Value Restrictions (LVRs), changes to the Credit Contracts and Consumer Finance Act require banks to undertake more detailed due diligence before approving mortgages to ensure that they are affordable and sustainable. Mortgage advisors report that banks are becoming increasingly wary of lending on new builds due to concerns about construction cost overruns.

82.2 **Interest rates**. With inflationary pressures building, the Reserve Bank has increased the Official Cash Rate (OCR) from a record low 0.25 percent to 2 percent. It is forecasting an OCR peak of around 3.9 percent by June 2023.This could see two-year fixed mortgage rates increase from recent lows of around 2.5 percent to north of 6 percent.

82.3 **Reduced population growth and declining house price expectations.** New Zealand's net population increased by just 0.38 percent in the year to March 2022 (compared to 2.37 percent in the year ending March 2021). Auckland's population actually fell 0.1 percent in the year to June 2021, the first decline on record.[13] House prices have already fallen 6.2 percent since the Nov 2021 peak, according to the REINZ House Price Index. Further, the Reserve Bank, and bank economists are now all forecasting house price corrections in the 2022/23 financial year. RBNZ estimates a fall in prices of 14% from peak to trough equating to over 20% in real terms. Combined with concerns about developer viability, this is reducing confidence to invest in new builds

83 Collectively, these factors suggest that some segments of the new build market may be about to stall. On the one hand, the sector is facing increased costs and risks that are reducing its appetite to commit to fixed price contracts. On the other hand, the sector's ability to ultimately pass these increased costs and risks onto consumers in the form of increased house prices is diminishing.

[13] Auckland's population falls for the first time | Stats NZ

Annex B: Overview of Government initiatives in place or under development to improve housing supply and affordability

System level interventions

- Land use planning and consenting: RMA review, NPS-UD and MDRS
- Building consenting system: Review of the Building Consenting System
- Infrastructure funding and financing: Infrastructure Funding and Financing Act and Infrastructure Acceleration Fund
- Costs and availability of building materials: Commerce Commission inquiry into the price of building products
- Labour supply and productivity: Immigration Rebalance; Apprenticeship Boost; and Mana in Mahi
- Urban Development Act
- Tax settings: 20-year exemption from denial of interest deductibility for new builds; and reduced bright-line test timeframe (5 years versus 10 years) or new builds

Government Build Programme

- Land acquisition and development: Land for Housing programme; and Kainga Ora Land Programme
- Public Housing: Public Housing Plan
- Transitional housing: Public Housing Plan
- Affordable housing: Affordable Housing Fund
- Whai Kāinga Whai Oranga

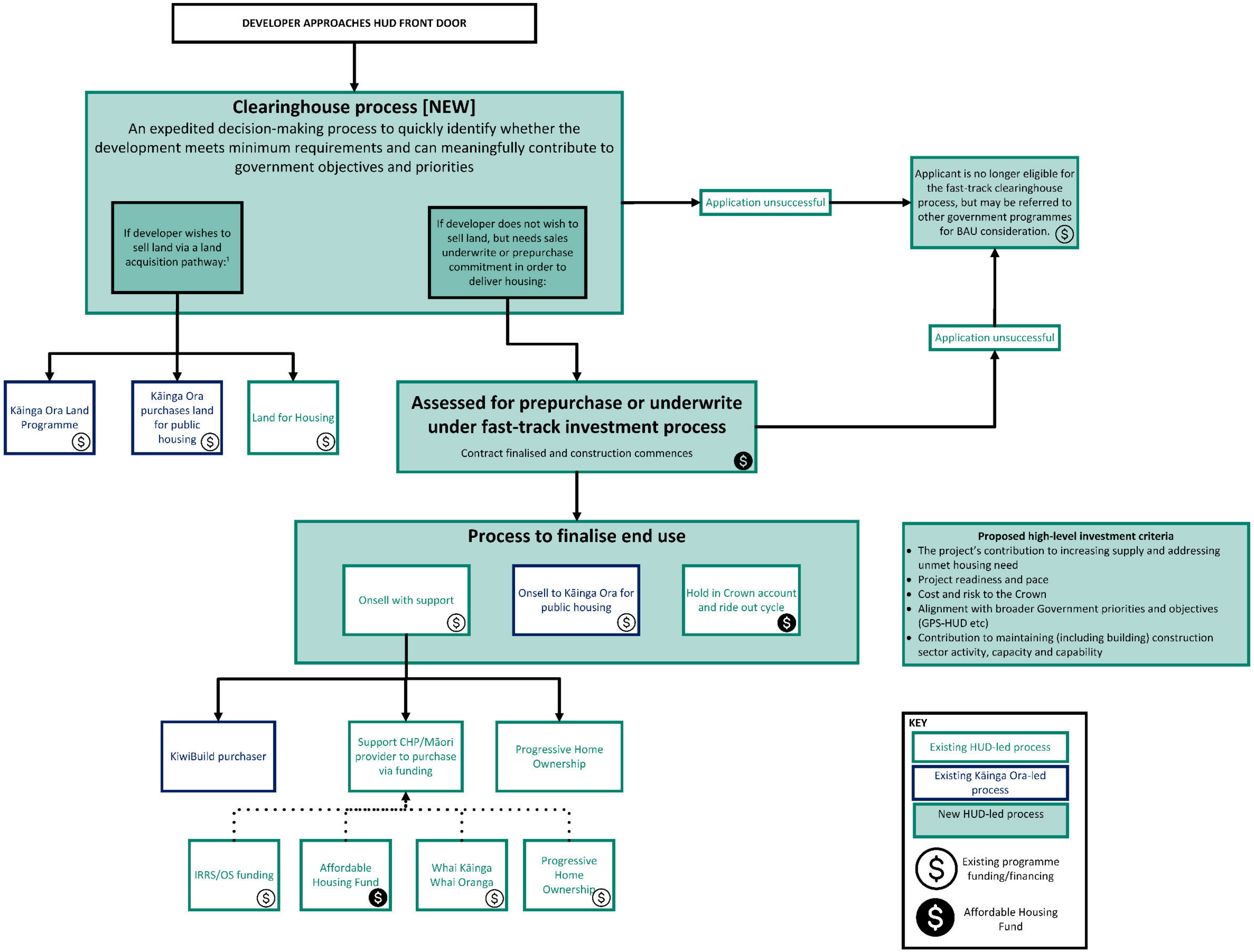
First Home Products

- Progressive Home Ownership: Progressive Home Ownership Fund
- Deposit assistance: First Home Grant
- Mortgage insurance: First Home Loan; and Kāinga Whenua Loan

Place based and cross-cutting strategies and interventions

- Strategy: GPS; Māori Housing Strategy; UGA; Homelessness Action Plan
- Partnerships: Place-based, urban growth and MAIHI partnerships

Annex C: Overview of the proposed clearinghouse process



¹ The standard eligibility processes and requirements for these existing programmes will apply, subject to any consequential amendments that are necessary for handling stalled and at-risk developments as agreed by Cabinet

Annex D: Indicative eligibility and assessment criteria for the clearinghouse

Indicative eligibility criteria
The applicant must own the land (or have an unconditional agreement to own or use the land)
Construction of the dwellings that they are seeking a prepurchase or underwrite for is yet to commence
Applicant must be an established residential developer/house builder, or a consortium of developers/housebuilders, with a proven track record of successfully delivering new housing within New Zealand
The development must meet minimum delivery targets e.g., a minimum of 8-10 houses (this can vary between places)
Development can deliver housing that is mostly or entirely under the relevant KiwiBuild price cap, with flexibility for >4 bedrooms
Applicant must be able to demonstrate that they have sufficient private support or finance on viable terms to progress the development, which is subject to securing pre-sale commitments or underwrites that they have made reasonable attempts to secure from the market
Project readiness –progression of the proposed development must not be contingent on other things that cannot be readily, confidently, and promptly resolved (for example, residual funding, resource consenting, supply chain or infrastructure barriers).
Forecast costs, revenues and margins are shared with the Crown on an open book basis
Indicative assessment criteria (to inform prioritisation of proposals)
The project's contribution to increasing supply and addressing unmet housing need for priority cohorts and locations, including its contribution to Māori housing outcomes
Project readiness and pace, including the speed with which construction can commence and/or stages can be completed.
Contribution to maintaining (including building) construction sector activity, capacity and capability – for example, number of jobs saved and/or additional jobs created due to the support.
Alignment with priority housing needs in the particular location (e.g. as identified through the Public Housing Plan and place-based assessments)
Alignment with broader Government priorities and objectives (GPS-HUD etc.)
Cost and risk to the Crown, which should be proportionate to the public benefits (from a whole of government perspective)