



Briefing

Costings and potential funding related to demand side support

Date:	21 August 2019	Security level:	In Confidence
Priority:	Medium	Report number:	BRF19/20080391

Action sought

	Action sought	Deadline
Hon Dr Megan Woods Minister of Housing	Agree to the recommendations	21 August 2019

Contact for discussion

Name	Position	Telephone	1 st contact
Caleb Johnstone	Manager, Market and Supply Responses	s 9(2)(a)	✓
Matthew Galt	Senior Advisor		

Other agencies consulted

Treasury, Housing New Zealand

Minister's office to complete

- ☐ Noted
- ☐ Seen
- ☐ See Minister's notes
- ☐ Needs change
- ☐ Overtaken by events
- ☐ Declined
- ☐ Referred to (specify)

Comments

Date returned to MHUD:



Briefing

Costings and potential funding related to demand side support

For: Hon Dr Megan Woods, Minister of Housing

Date: 21 August 2019

Security level: In Confidence

Priority: Medium

Report number: BRF19/20080391

Purpose

1. This briefing outlines the costings and potential funding sources for the changes to the KiwiSaver HomeStart Grant and Welcome Home Loan, and the administration of a progressive homeownership fund, as proposed in the build reset.

Recommended actions

It is recommended that you:

1. **Note** that the costs of the proposed changes are:

- a) \$1.4m to make HomeStart grants available to all eligible buyers
- b) \$17.3m to reduce the HomeStart deposit requirement from 10% to 5%
- c) \$4.0m to reduce the Welcome Home Loan deposit requirement from 10% to 5%.

Noted

- 2.

s 9(2)(f)(iv)

3. **Note** that the Welcome Home Loan and HomeStart underspends can fund the HomeStart and Welcome Home Loan changes, although using the HomeStart underspend would be inconsistent with the Fiscal Management Approach.

Noted

4. **Note** that using the HomeStart underspend outside of the Fiscal Management Approach requires agreement from the Minister of Finance and Cabinet.

Noted

5. **Agree** to discuss using the HomeStart underspend outside of the Fiscal Management Approach with the Minister of Finance.

Agree/disagree

6. **Agree** that, subsequent to the changes noted in recommendation 1, the HomeStart appropriation be managed in accordance with the Fiscal Management Approach. This will include regular reforecasts and funding policy changes through the Budget allowances.

Agree/disagree

7.

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Noted

8.

Noted



Caleb Johnstone
**Manager, Market and Supply
Responses**

21/8/19

Hon Dr Megan Woods
Minister of Housing

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Executive summary

2. You have requested that the following changes be made as part of the KiwiBuild reset:
 - a. Making HomeStart grants available to all buyers, for both new and existing homes. Currently grants are only paid up to a maximum of \$10,000 for an existing home and \$20,000 for a new build, meaning that many people in groups of buyers are not eligible for the full grant amount on a per person basis.
 - b. Reducing the deposit requirement on HomeStart grants from 10% to 5%.
 - c. Reducing the deposit requirement on Welcome Home Loan from 10% to 5%.
3. In addition, you have requested that the HomeStart grant and the Welcome Home Loan scheme be rebranded to 'First Home Grant' and 'First Home Loan'. This briefing does not further discuss the rebranding and focusses on the cost and funding of changes 2(a) to 2(c).
4. The benefits for first home buyers and the costs of these changes are summarised in the table below. The total cost is estimated at \$22.6m (\$18.7m for HomeStart and \$4.0m for Welcome Home Loan). However, there is uncertainty around the costs as a result of uncertainty about how much uptake there will be in response to the changes.

Figure 1: The proposed criteria changes

Change	Benefits for first home buyers	Estimated cost (current financial year plus next four financial years)
Make HomeStart grants available for all buyers	- Groups of buyers no longer disadvantaged where they otherwise meet the eligibility criteria.	\$1.4m
Reduce HomeStart deposit requirement to 5%	- Households who can service a mortgage can buy a home sooner - Households currently buying with a 5-10% deposit can receive the grant if they are otherwise eligible.	\$17.3m
Reduce Welcome Home Loan deposit requirement to 5%	- Households who can service a mortgage can buy a home sooner as the deposit barrier is effectively eliminated (given KiwiSaver and HomeStart alone will often make up a 5% deposit). - First home buyers with only a 5-10% deposit can use the Welcome Home Loan scheme, rather than applying for a more expensive high Loan to Value Ratio mortgage (which banks may or may not approve to a given customer).	\$4.0m
Total cost		\$22.6m¹

5. The HomeStart and Welcome Home Loan underspends are large enough to absorb these changes. Last year HomeStart and Welcome Home Loan costs were \$21.3m and \$2m below their current appropriations respectively. However:
 - a. the underspends are expected to get smaller over time, so it is unlikely that any further changes could be funded from the underspends beyond those proposed.
 - b. only the Welcome Home Loan underspend can be easily repurposed under the Fiscal Management Approach. The HomeStart underspend is not available to be repurposed

¹ This comes to \$22.6 rather than \$22.7m due to rounding of the cost for each change.

unless the Minister of Finance agrees to do this outside of the Fiscal Management Approach. The HomeStart appropriation is a Benefit or Related Expense (BORE) appropriation. Under the Fiscal Management Approach, underspends from BOREs are required to be returned to the centre, and overspends are funded from the centre. This ensures that underspends and overspends net off. Using BORE underspends is not fiscally neutral considering the whole fiscal system. Doing so will tend to bias up BORE spending across the system. Past treatment of the HomeStart appropriation has been inconsistent with the Fiscal Management Approach, including using underspends to fund eligibility criteria changes in 2016 and 2018, and not regularly reforecasting the appropriation to match demand. Although officials retained a buffer in the appropriation to allow for any increased demand.

6. Treasury does not support using the HomeStart underspend at all outside of the Fiscal Management Approach. However, you could engage the Minister of Finance about the use of the HomeStart underspend outside of the Fiscal Management Approach on the following basis:
 - a. The underspend is significant for the next couple of years, and can fund the proposed policy changes (acknowledging that this is not fiscally neutral considering the whole fiscal system).
 - b. Using the underspend would be consistent with how HomeStart has been managed over at least the past four years.
 - c. A contributing factor to the underspend has likely been that rising house prices have made it difficult for first home buyers to buy affordable homes using the grant. There is therefore logic to using the underspend to help first home buyers.
7. Officials will manage the appropriation as required under the Fiscal Management Approach from now on by developing a robust forecasting model over the coming months and taking changes to the policy settings through the Budget process, as is required for BOREs under the Fiscal Management Approach.
8. You have requested advice on what funding options are available for the delivery of a government progressive homeownership scheme. Beyond the capital funding required to establish a progressive homeownership scheme and fund the operating, and concessionary costs.

9. s 9(2)(f)(iv)

10.

Background

11. You have indicated that your preferred changes to the HomeStart grant and Welcome Home Loan are to:
 - a. make HomeStart grants available for all buyers
 - b. reduce HomeStart deposit requirement to 5%
 - c. reduce Welcome Home Loan deposit requirement to 5%.
12. The changes that are currently proposed in the build reset Cabinet paper differ from the changes previously proposed in several ways:
 - a. doubling HomeStart grants for new builds is no longer a preferred option given it will be poorly targeted and expensive,
 - b. the reduction in the deposit requirement is proposed to apply to both new and existing homes (rather than only new homes) to ensure regional areas can also benefit, and
 - c. no changes have been made to the proposal to make grants available to all buyers, although the build reset paper clarifies that Housing New Zealand currently does pay grants in some cases of multiple buyers.²
13. You have indicated that further changes may be considered at a later date outside of the current stage of the build reset. These could include the HomeStart and Welcome Home Loan house price caps, income caps, and the operational and marketing processes that could be changed to make it easier for first home buyers to use the products.

HomeStart changes

Costs

14. Figure 2 summarises the impact and cost of the proposed changes to HomeStart. These sum to \$18.7m over the forecast period. The costings are assessed over 4.75 years, covering the current financial year (three quarters of a year, assuming the changes come into effect from 1 October) plus the following four full financial years.
15. All cost estimates in this paper are sensitive to the assumptions used and could vary widely either side of these, depending on how demand evolves. However, they are currently our best judgement.
16. The details of the costings are as follows:
 - a. We estimate that the cost of making the full grants available to all buyers would be \$1.4m. This cost arises as an estimated 60-80 households per year will receive an additional \$4,000 worth of grants.³
 - b. We estimate that the cost of reducing the deposit requirement for HomeStart grants to 5% would be \$17.3m. These costs arise because:
 - i. An additional estimated 260 households per year who are already buying with a 5-10% deposits but who would otherwise be eligible for the grant, will now be

² Grants are paid up to a maximum of \$10,000 for an existing home and \$20,000 for a new build, meaning that many people in groups of buyers are not eligible for the full grant amount on a per person basis. For example, three people buying a home together and each eligible for a \$5,000 grant would only be paid \$3,333 each instead of their full entitlement. We estimate that the average multiple buyer household misses out on \$4,000 worth of grants due to the cap.

³ This is estimated as follows: The prevalence of multiple borrowers is based on figures from the Welcome Home Loan scheme, which is 0.5% of buyers (we have greater confidence in this number than in the 0.8% of HomeStart users buying in groups of three or more previously used). Assuming this is representative of HomeStart buyers, this gives 60 households per year who could benefit from the change, which rises to 80 over time allowing for general growth in HomeStart uptake. We estimate that the average multiple buyer household will miss out on \$4000 worth of grants based on the prevalence of 3 year, 4 year and 5 year grants and the possible combinations of households. No allowance has been made for additional households who may buy a HomeStart-eligible home together as a result of the change, given the complexity of completing a multi-borrower purchase.

able to access it.⁴ This number is assumed to grow over time in line with overall HomeStart uptake at a rate of 7% per year.

- ii. Some households who can service a mortgage will be able to buy a home sooner using a Welcome Home Loan. The number of households is difficult to estimate but we estimate this to be just over 1,000 households over the forecast period.
- c. Overall, this results in another 2,400 homes being bought with the help of a HomeStart grant over the forecast period. This is equal to 3.5% of the number of grants currently paid.

Figure 2: Costs of the changes

Financial year	Making grants available to all buyers		Reducing the HomeStart deposit to 5%		Total HomeStart changes
	Households benefiting	Cost (\$m)	Additional homes bought with the help of a grant	Cost (\$m)	
19/20 (1 Oct to 31 May only)	47	0.19	328	2.4	2.5
20/21	68	0.27	468	3.4	3.6
21/22	72	0.29	500	3.6	3.9
22/23	77	0.31	535	3.8	4.2
23/24	83	0.33	573	4.1	4.4
Total	347	1.39	2404	17.3	18.7

Funding the change with the HomeStart underspend

17. The HomeStart appropriation was underspent by \$21.3 in the 2018/19 financial year (\$84.8m spent compared to an appropriation of \$106.12m). The underspend is likely to shrink over time but will remain to some degree for the next couple of years.
18. You may use the underspend to fund the proposed changes to HomeStart, bearing in mind that:
 - a. the underspend is unlikely to be large enough to fund further changes beyond the \$18.7m worth of HomeStart changes that are currently proposed, and
 - b. using the underspend would be an exception to the Fiscal Management Approach, so would require agreement from the Minister of Finance and Cabinet.
19. Each of these points are elaborated on below.

The size of the underspend

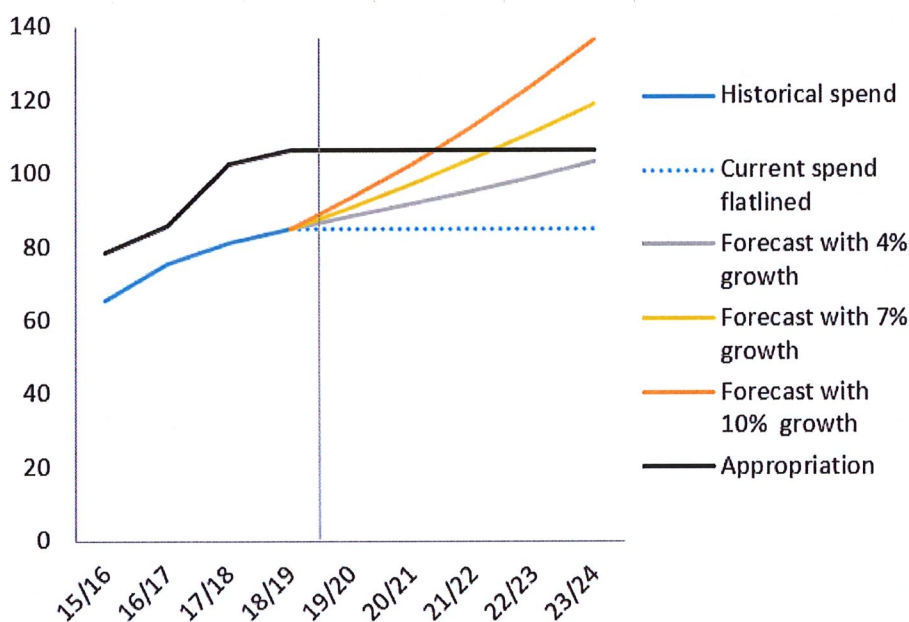
20. The HomeStart underspend is currently significant and is likely to be large enough to be repurposed to fund the proposed changes. However, we expect HomeStart uptake in general

⁴ We estimate this as follows: Reserve Bank of New Zealand data indicates that around 4.5% of first home buyers are already buying with deposits of between 5% and 10%. Around 40% of first home buyers use a HomeStart grant (based on comparing HomeStart data and RBNZ data). However, those buying with less than a 10% deposit are less likely than other buyers to be eligible for HomeStart under the income and house price criteria. HomeStart data indicates that buyers with low deposits tend to have high incomes and be buying high priced homes. In addition, people with a 5-10% deposit would be incentivised to wait until they have a 10% deposit in order to access HomeStart. We therefore assume that 20% of current low deposit FHBs will be eligible for HomeStart if the cap is reduced. This would be 235 first home buyer households, plus 10% to allow for previous homeowners (the current share) to give a total of 260 households per year who would become eligible for the grant.

to rise over time, so there is unlikely to be surplus funding beyond the \$18.7m required for the proposed changes.

21. HomeStart is a Benefit or Related Expense (BORE) appropriation. These appropriations are commonly used to fund benefits (such as social welfare benefits) paid to people who have a legal entitlement to them. The level of these appropriations is intended to be officials' best forecast of future uptake. However, the appropriation forecast has not been reforecast since at least 2016. In the last Budget, rather than aligning the appropriation at officials' best forecast of uptake, a buffer was retained to ensure that there was sufficient funding available for increases in demand.
22. Officials intend to re-forecast HomeStart properly over the coming months. After this the cumulative underspend may be small. Figure 3 shows how HomeStart spending might increase over time, reducing the size of the underspend. There are several reasons why we expect the underspend to shrink over time:
 - a. HomeStart spending has been rising at a rate of 4%-12% over the past two years.
 - b. The number of people with KiwiSaver membership around homebuying age (25-44) is likely to grow at around 4-6% per year, and this will increase the pool of eligible HomeStart users.
 - c. It seems likely that the proportion of new builds priced below the HomeStart house price caps will rise as a result of the government build programme and flattening house prices. This is an important change from the past as rising house prices have been a key driver holding down HomeStart spending historically (generating the underspend).
 - d. The government's broader housing programme, such as the introduction of additional support for first home buyers, might increase the overall number of first home buyers.
23. Depending on the rate of growth that occurs, there could be a cumulative underspend or overspend over the forecast period. If uptake rises slowly (such as at 4% per year) there will be a cumulative underspend of \$53m through to June 2024. In contrast, if uptake rises quickly (such as at 10% per year) there will be a cumulative overspend of \$39m through to June 2024. A proper reforecast will confirm what funds are required.

Figure 3: HomeStart spending relative to the appropriation and possible forecasts.



Using the underspend under the Fiscal Management Approach

24. The rules applying to BOREs under the Fiscal Management Approach are designed so that funding is flexible enough to meet demand from all eligible people, without incentivising overspends. There are two different processes for changing the appropriation depending on the driver of the change:
 - a. Spending due to **demand** (arising from external factors, such as economic changes) can be funded through a reforecast outside of the Budget process. Likewise, surplus underspends are expected to be returned to the centre so that overspends and underspends net off.
 - b. Spending due to **policy changes** (such as arising from changes in eligibility criteria) are through the Budget process, or the Between Budget Contingency (BBC).
25. The HomeStart underspend has arisen due to lower than expected demand and the long period that has passed since it was last reforecast. The underspend should have been returned to the centre last Budget.
26. Using BORE underspends to fund policy changes is not fiscally neutral considering the whole fiscal system. There is the potential that doing so will systematically bias up spending across all BOREs as overspends would be automatically funded but underspends would rarely be returned to the centre. Over time this will require additional funding to be provided for BOREs.
27. The underspend can be used as an exception to the Fiscal Management Approach, with agreement from Cabinet and the Minister of Finance. Treasury does not support this option, as it:
 - a. is inconsistent with the Fiscal Management Approach
 - b. may cause different treatment between HUD and other agencies that have been asked to request new funding for policy-driven BORE increases
 - c. may solidify the precedent that BORE underspends can be used to fund policy changes to HomeStart.
28. Furthermore, making a policy change and not counting it against the Budget or BBC at the time it is made creates ambiguity about whether future adjustments to the appropriation are due to the previous policy changes or to changes in demand since the changes were made. Under the Fiscal Management Approach, future adjustments to the appropriation that are due to the previous policy changes must go through the Budget process and not through the standard BORE process.
29. However, you could make the case to use the underspend to fund the changes on the following basis:
 - a. The underspend is significant for the next couple of years and can fund the proposed policy changes (acknowledging that this is not fiscally neutral considering the whole fiscal system).
 - b. Using the underspend would be consistent with how HomeStart has been managed over at least the past four years.
 - c. A contributing factor to the underspend has likely been that rising house prices have made it difficult for first home buyers to buy affordable homes using the grant. There is therefore logic to using the underspend to help first home buyers.
30. Officials intend to manage the appropriation as required under the Fiscal Management Approach from now on by developing a robust forecasting model over the coming months and taking policy changes through the Budget process.

Welcome Home Loan changes

Cost

31. We estimate that the cost of reducing the Welcome Home Loan deposit to 5% would be \$4m over the forecast period (Figure 4). Reducing the deposit requirement will have two effects:
- some households will be able to buy a home earlier, and
 - the change will mean that the Welcome Home Loan scheme matches the 5% deposit mortgages offered by some banks, allowing some first home buyers to switch from commercial loans to cheaper Welcome Home Loan.⁵
32. This costing is difficult to assess as we have no strong basis to forecast the effect of the change on uptake. For the purposes of estimating a cost, we assume an additional 1,000 Welcome Home Loan will be drawn over the forecast period as a result of the change.⁶ This is around one sixth more than are expected if the deposit requirement is kept at 10%.

Figure 4: cost of Welcome Home Loan changes

Financial year	Additional loans (number)	Additional loans (\$m)	Cost (\$m - 1.2% of loan amount)
19/20 (1 Oct to 30 Sep)	51	16	0.2
20/21	135	43	0.5
21/22	202	66	0.8
22/23	268	91	1.1
23/24	334	116	1.4
Total	990	332	4.0

Funding with the Welcome Home Loan underspend

33. Unlike HomeStart, the Welcome Home Loan appropriation is a non-departmental expense, so underspends are available to fund policy changes under the Fiscal Management Approach.
34. The Welcome Home Loan appropriation is \$7.7m, and had an underspend of \$2m. Although as with HomeStart, the cumulative future expected underspend is difficult to forecast. Welcome Home Loan uptake is highly variable, depending on mortgage market conditions and the extent to which individual banks promote the product. We assume that, were it not for the reduction in the deposit requirement, growth in Welcome Home Loan uptake would have been slower than for HomeStart. Growth will be constrained for at least the next couple of years as a result of HNZ updating its serviceability requirements as part of prudent risk management.⁷
35. Based on an assumption of no growth, there is an underspend of \$9.5m through to June 2024 (including the assumed underspend from the first quarter of the 2019/20 financial year).

⁵ The Welcome Home Loan scheme tends to be cheaper for first home buyers than commercial bank loans as standard interest rates are charged on it, rather than high-LVR rates (which are around 0.5 percentage points higher). Reducing the deposit requirement to 5% will make homeownership more affordable for households with only a 5%-10% deposit.

⁶ This is estimated as follows: Under the current settings of the appropriation, the cost is the current risk charge paid by the government (1.2% of the loan amount) on any additional growth in loan volumes. Allowing for the average Welcome Home Loan drawn to be \$335,000 over the forecast period, the cost comes to \$4.0m (1.2%*\$335,000*1000).

⁷ HNZ is amending its serviceability policy as part of its regular operational processes to ensure that risks are well managed. The change involves updating household expenditure estimates to more closely reflect actual expenditure and raise the income level needed to get a mortgage. Indicative analysis undertaken by HNZ suggests that the change may result in a reduction in Welcome Home Loan approvals by around a quarter, although this analysis is only approximate.

If we assume an annual growth of 5%, the forecast underspend is \$5.3m – still enough to fund the proposed Welcome Home Loan changes.

36. It is possible that the underspend is larger than this. A recent actuarial assessment indicated that the actual risk for a Welcome Home Loan is 0.43% of the loan amount, rather than the 2.2% currently provisioned for. The risk charge may be able to be reviewed to reduce the amount of funding required for the Welcome Home Loan scheme, releasing some more of the appropriation, or to reduce the amount charged to the borrower. However, such a review will require further actuarial and accounting input, so is best done on a slower timeframe than as part of this stage of the build reset.

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