



Briefing

ESTABLISHING A GENERAL UNDERWRITE TO MAINTAIN HOUSE CONSTRUCTION			
To Minister	Hon Nicola Willis	Portfolio	Minister of Finance
To Minister	Hon Chris Bishop	Portfolio	Minister of Housing
Date	18/07/24	Priority	Medium
Tracking number	HUD2024-004928		

ACTION SOUGHT	
Action sought	Agree the objectives, eligibility and prioritisation criteria, and administrative responsibilities for the general underwrite.
Deadline	26/07/24

CONTACT FOR DISCUSSION			
Name	Position	Telephone	1st contact
Jane Keane	Manager, Housing Supply and Affordability	04 832 2564	✓
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OTHER AGENCIES CONSULTED
Treasury and MBIE were consulted. The briefing was informed by targeted in-confidence testing with Kāinga Ora, Residential Sector Reference Group members, and financiers.



RECOMMENDED ACTIONS

It is recommended that you:

1. **Note** Cabinet agreed to replace KiwiBuild and Build Ready Developments (BRD) with a general underwrite to mitigate the residential construction downturn. *Noted*
2. **Agree** that the new underwrite has the following objectives: *Agree/Disagree*
 - a. Primary objective: maximising overall housing supply, while minimising the costs and risks to the Crown.
 - b. Secondary objective: accelerating development of Government owned land.
3. **Note** this means the general underwrite will focus on main centres. *Noted*
4. **Agree** that to qualify for an underwrite, applicants must: *Agree/Disagree*
 - a. Be an established developer with a proven track record;
 - b. Have secured ownership or use of the land (or an option to do so), along with any required resource consents;
 - c. Provide satisfactory evidence that underwrites are needed for the development to proceed within 6 - 12 months;
 - d. Be seeking support for a development (or stage of development) that will deliver at least 30 homes;
 - e. Agree to provide a recent market valuation approved by the Crown prior to any underwrite being agreed.
5. **Agree** to developments being prioritised based on the following criteria (to be weighted): *Agree/Disagree*
 - a. Project readiness, including expected commencement date and staging;
 - b. Volume and nature of supply, including number of bedrooms;
 - c. Location (including the degree of unmet housing need, projected population growth, and proximity to nearby amenities and transport links);
 - d. Net cost and risk to Crown.



6.	Note we are not proposing any minimum design criteria beyond the Building Code and Healthy Homes standards.	<i>Noted</i>
7.	Agree to either:	
	a. Retain responsibility for approving all underwriting deals (with the option of subdelegating to officials later).	<i>Agree/Disagree</i>
	Or	
	b. Sub-delegate underwriting decisions to officials from the outset (recommended).	<i>Agree/Disagree</i>
8.	Agree that HUD administer the new underwrite, drawing on a mix of internal resources, Kāinga Ora resources (subject to agreeing terms), and expert consultants with relevant skills and experience.	<i>Agree/Disagree</i>
9.	Note that HUD’s ability to administer the programme is conditional on securing funding for programme administration and expert consultants; s 9(2)(f)(iii)	<i>Noted</i>
10.	Note that officials will report back to you in late August 2024 (to support a September launch) with:	<i>Noted</i>
	a. A detailed implementation and communications plan;	
	b. Further advice on the approach to winding down KiwiBuild;	
	c. Detailed financial recommendations for the October Baseline Update (including administration costs);	
	d. A paper seeking your direction on the Carrington development.	

Hilary Joy
General Manager, System Policy
18 /07 /24

Hon Nicola Willis
Minister of Finance
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Hon Chris Bishop
Minister of Housing
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Purpose

1. This briefing seeks agreement to the detailed policy settings and implementation approach for a new time limited general underwriting programme.

Executive summary

2. Cabinet has agreed to replace KiwiBuild and Build Ready Developments (BRD) with a general sales underwrite, and jointly authorised you to make any decisions reasonably necessary to give effect to this (drawing on the existing underwriting appropriations) [ECO-24-MIN-0121 and CAB-24-MIN-0246 refer].
3. Underwrites are a cost-effective way of maintaining financier appetite for residential developments in soft markets, reducing the impact of market downturns and supporting a faster and less inflationary recovery. They involve a Crown commitment to purchase homes at a pre-agreed price if the developer is unable to secure their own buyers.
4. We propose the general underwrite have a primary objective of maximising housing supply (the corollary of which is minimising the costs and risks to the Crown per home enabled); and a supporting objective of accelerating development of Government-owned land to reduce holding costs and support capital recycling, where practical. This means it will focus on the main centres.
5. We also propose (see below for a fuller explanation) that:
 - a. Applicants must meet minimum eligibility criteria relating to: their track record; access to the land and any required resource consents; demonstrated need for an underwrite; project size (minimum 30 homes); and willingness to provide a recent market valuation for the development.
 - b. Applications that meet the minimum eligibility criteria are prioritised based on weighted evaluation criteria relating to project readiness; volume and nature of supply; location; and the net costs and risks to the Crown. We will come back to you with recommended weightings. Consistent with the proposed objectives, we expect they will favour projects that will deliver the most homes for the least net cost and risk to the Crown (all other things being equal).
6. Underwrites are relatively low risk, provided they are set at a reasonable discount to the expected market value of the completed homes. The latest RBNZ forecasts suggest buyer demand and house prices will be higher in 18 to 24 months' time when the first underwritten homes are likely to be completed. The Crown is shielded from development risks, as underwrites can only be triggered on completed homes.
7. Our initial estimates, based on conservative assumptions around the risk of underwrites being triggered, suggest that we could underwrite around s 9(2)(g)(i) at any point in time with the available headroom in existing underwriting appropriations. Additional funding will be required for programme administration and expert



consultants (estimated at \$1.5 million in the first year). HUD cannot absorb these costs. We are exploring the potential to fund them from some of the s 9(2)(f)(iii)

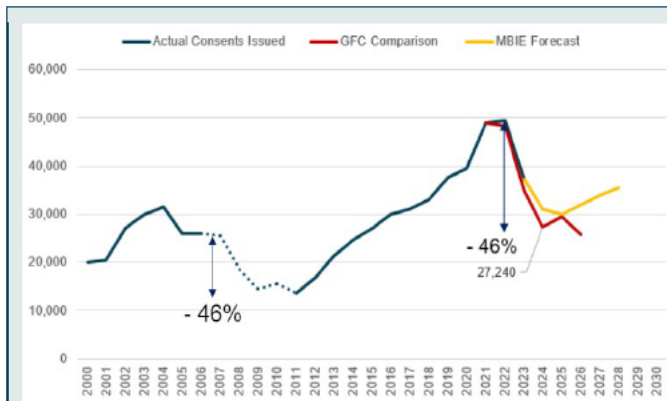
8. Subject to your agreement, we will report back to you in late August 2024 with a detailed implementation plan and proposed appropriation changes to establish the general underwrite and support a September 2024 launch date.
9. While the general underwrite is expected to be available as a time bound initiative for up to 12 months, we will provide further advice on any ongoing role for underwrites as part of the November 2024 report back on resetting Government investment in housing and urban development.

Background

10. On 1 July 2024, Cabinet agreed to end KiwiBuild and BRD and move to a single underwriting programme to mitigate the residential construction downturn, that:
 - a. prioritises housing supply in main centres where buyer demand is more likely to recover quickly, reducing the underwriting risk;
 - b. has no limits on who can buy the underwritten homes, to increase the pool of potential buyers; and
 - c. sets underwrites at a discount to the expected market value of the homes, once completed, to ensure developers are appropriately incentivised to actively build, market, and sell underwritten homes.
11. Cabinet authorised you to make any decisions reasonably necessary to give effect to these decisions, drawing on the existing KiwiBuild and BRD appropriations. This briefing seeks your agreement to the proposed settings for the general underwrite.

Market context

12. The residential construction sector is particularly prone to boom-bust cycles, during which skills and businesses are quick to exit, but slow to recover.
13. Annual housing consents fell from a peak of 51,000 in May 2022, to 35,000 in May 2024. MBIE has forecast further declines to 31,000 by the end of 2024 and 30,000 in 2025. Sector feedback suggests activity could fall to around 25,000 consents.
14. Percentage wise, this is comparable to the GFC when consents fell 46 percent and the sector lost around 25 percent of its workforce. Some regions took 12 years to recover.



Time taken to return to pre-GFC levels of construction by region	
Region	Number of years
Auckland	7 years
Christchurch	6 years (post-earthquake activity)
Wellington	9 years
Waikato	12 years
Bay of Plenty	9 years
Northland	11 years

15. The current slowdown is occurring despite unmet housing needs. Net population growth is running ahead of consents, contributing to upward pressure on rents, increased crowding, and delayed household formation. While developers and financiers are acting rationally in the circumstances, the flow on impacts are quickly socialised including through increased demand for social and emergency housing.
16. The underlying drivers of the mismatch between construction demand and population growth are complex, and include:
 - a. **The cost and availability of finance.** The sector is capital intensive, and particularly sensitive to changes in interest rates; which rapidly impact new developments and buyers. It takes longer for rising interest rates to flow through to existing homeowners (when they refix) and, ultimately, consumer spending.
 - b. **Higher construction costs, coupled with lower house prices.** While construction costs have stabilised, the Reserve Bank notes nationwide house prices increased only modestly over the past year having declined over 15 percent from their 2021 peak.
17. These factors are contributing to weak “off the plans” demand for new builds. Short bank pre-approval periods, and concerns about interest rates and the health of the sector create risks for home buyers. There is also a high inventory of older, recently completed or soon to be completed dwellings buyers can choose from.

How an underwrite will help

18. Sales underwrites help developers meet their financiers’ presale requirements, access development finance, and commence construction. They are particularly effective at:
 - a. Maintaining construction sector momentum and capacity during market downturns, when presales are harder to achieve; and
 - b. Accelerating recovery and reducing construction and house price inflation when demand returns.



19. Underwrites essential bridge current and future housing demand. They are relatively low risk, if set at a reasonable discount to the expected market value of the completed homes (while still providing developers and their financiers with an acceptable risk-adjusted return). Sector feedback suggests that there are lots of consented developments stalled due to insufficient presales, and contractors looking for work (noting tendering work to subcontractors could take up to 3 months).
20. The RBNZ's May 2024 Monetary Policy Statement suggests demand will be higher in 18 to 24 months' time when the first underwritten homes are likely to be completed. The OCR is forecast to fall to 5.1 percent by December 2025, and 3.7 percent by December 2026, with house price inflation gradually returning to its long-rate average of around five percent. More migrants will qualify to purchase a home by then too.¹ These factors should help to reduce the unsold inventory of existing homes, and support demand for underwritten homes once completed.



Overarching objectives

21. We propose the following objectives for the general underwrite:
- Primary objective: maximising overall housing supply** (the corollary of which is minimising the costs and risks to the Crown per home enabled). Focusing on volume is the most effective way to maintain construction sector capacity and capability (~ four jobs per home for 12 months) and place downwards pressure on rents, house prices and construction costs over the medium-term. As agreed by Cabinet, this will require a primary focus on major centres where developments are more likely to be commercially viable without an explicit subsidy, and buyer demand is expected to recover more quickly.
 - Secondary objective: accelerating development of Government owned land**, to reduce the Government's holding costs and support faster recycling of the Government's investment in that land. These projects will still need to deliver good overall value for money relative to other underwriting opportunities.
22. These objectives reflect the agreed investment principles for resetting Government

¹ Migrants on residents' visas must be in the country for at least 12 months before they can purchase property.



investment in housing and urban development.² We have focussed on the overall supply and value for money principles, as our ability to reduce motel use and relieve pressure on the Social Housing Register absent an explicit subsidy is limited, particularly in places with poor development economics. Boosting overall supply will help at the margins, as will underwriting market sales in mixed developments incorporating social housing (e.g. some Land for Housing projects).

Eligibility and assessment criteria

23. Clear and transparent eligibility and assessment criteria are important for ensuring that applicants do not waste time and effort preparing underwriting applications that are unlikely to succeed, and that the Crown secures maximum impact from its investment.

Minimum eligibility

24. To qualify for an underwrite, we propose that the applicant must:

- a. Be an established developer with a proven track record of successfully building and selling homes (i.e. based on previous comparable projects and/or any sales already secured in the current development);
- b. Have secured ownership or use of the land (or an option to do so), along with all relevant resource consents for residential housing;
- c. Provide satisfactory evidence underwrites are needed for the development to proceed within 6 - 12 months (e.g. evidence that they have made reasonable attempts to market the development³, finance approval is conditional on securing presales, and there are workers/subcontractors available);
- d. Be seeking support for a development (or stage of development) that will deliver at least 30 homes; and
- e. Agree to provide a recent market valuation (from a registered valuer approved by the Crown) for the development prior to any underwrite being agreed.

25. The criteria will ensure work can proceed at pace, delivering homes that are genuinely additional to what could have been delivered in the timeframe absent an underwrite.

26. The minimum development size will deliver administrative efficiencies for the Crown, while smaller firms can still subcontract to, or form consortia with, larger developers. Where to set the minimum is a judgement call. The downside of larger developments is the concentration of sales risk in one place. This can be managed by staggering housing completions, where practical.

27. We are not proposing any minimum design criteria (other than the Building Code and

² Cabinet agreed three investment principles: increasing supply; applying a social investment approach (including to reduce the Housing Register and get people out of motels); and ensuring investments optimise value for money. [ECO-24-MIN-0121 and CAB-24-MIN-0246 refer].

³ This requirement may not be appropriate for apartments. Some developers have paused marketing as they don't want to accept deposits when it's uncertain whether they'll achieve enough presales to commence construction.



Healthy Homes standards), as these are often subjective and could lead to costly and time-consuming reworking of designs and consents. Apartments below around 40 square metres may be assessed as being too risky (given banks are often reluctant to grant mortgagees on them). Housing quality will also be reflected in market valuations.

28. While we are not proposing any hard price caps, market values will be a factor in assessing value for money. We can typically underwrite a higher number of cheaper houses with a given amount of underwrite funding.

Assessment and prioritisation

29. Applications that meet the minimum eligibility criteria will be prioritised based on the following assessment criteria:
- a. project readiness, including expected commencement date and staging;
 - b. volume and nature of supply, including number of bedrooms;
 - c. location (including the degree of unmet housing need, projected population growth, household incomes and proximity to amenities and transport); and
 - d. net cost and risk to Crown (financial analysis including value for money).
30. Timing is key to ensuring underwrites provide support during the worst of the downturn, with homes completed as buyer demand returns. A time-bound intervention will support delivery while further system reforms like Going for Housing Growth, resetting Government investment in housing and urban development, building consenting changes, and the response to the Kāinga Ora review are developed.
31. The assessment of net cost and risk will consider several factors including:
- a. the average price of the underwritten homes (the lower, the better);
 - b. the proportion of homes in the development or stage that the Crown needs to underwrite (the lower, the better);⁴
 - c. the underwriting discount relative to market value (likely to be between 6 and 15 percent, depending on the project);
 - d. project staging (i.e. if too many homes are completed in the same place at the same time, this will increase the sales/market absorption risks); and
 - e. any offsetting Crown savings or revenues. This could include reduced holding costs and faster capital recycling on projects involving Government land, or the potential for the Crown to receive a share of any excess profit.⁵

⁴ This will typically be no more than required to meet the financier's required equity/presale cover ratio, typically around 130 percent of total first ranking debt.

⁵ Profit sharing arrangement are a common feature of Land for Housing deals. They ensure development partners do not receive windfall gains from Government subsidies (such as deferred settlement or land write-downs) if projects are more profitable than anticipated. Similarly, where the Crown is sharing downside risk via an underwrite it should arguably benefit from any upside.



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

Administration and decision making

33. The Minister of Housing has expressed a preference for Kāinga Ora to focus on its core social housing role. We therefore propose that the general underwrite is administered by HUD, drawing on a mix of internal resources, Kāinga Ora resources (subject to agreeing terms), and expert consultants (e.g. valuer, quantity surveyor, and planner) with relevant skills and experience in this area.
34. Using specialist skills and knowledge will provide assurance on projects and minimise risk to the Crown. This could include having industry experts assisting with assessing and prioritising proposals.

Ministerial decision making and sub-delegations

35. As noted above, you have joint delegated authority to make any decisions reasonably necessary to give effect to the general underwrite. This is consistent with the:
- Minister of Finance's statutory functions under the Public Finance Act, which include giving guarantees (including underwrites) where it appears "to be necessary and expedient in the public interest to do so"; and
 - Minister of Housing's statutory functions under the Housing Act 1955, which include determining what land or dwellings may be acquired under the Act for housing purposes and any other matters of state housing policy.
36. A key choice is whether to retain responsibility for approving all underwrites, or subdelegate your decision rights to officials, via the relevant Chief Executive (recommended). Alternatively, you could retain responsibility for the initial deals and consider whether to subdelegate some or all of your responsibilities to officials once you are comfortable with the robustness of the evaluation, due diligence, and risk management processes. If you wish to subdelegate, we will prepare delegation instruments for your approval.

Information to support informed decision making

37. If you choose to retain your decision making role, we will provide you with the following information to support decision making:
- market conditions (including expected demand);
 - price points (including market value, underwrite price);
 - delivery (expected staging and/or completion dates);
 - appropriation (capacity within existing appropriations based on total exposure);



- e. further risks, considerations, and mitigations; and
 - f. the commercial terms of the underwrite contract.
38. If you choose to subdelegate decision making to officials, we will provide you with regular (quarterly, or more frequently if preferred) reporting on:
- a. locations of underwrites across the country;
 - b. expected staging and/or completion dates of homes; and
 - c. total underwriting exposure (and any other risks and mitigations).

Acquisition, management, and disposal of homes

39. If underwrites are triggered, like KiwiBuild and BRD, homes will be acquired in the name of the Crown and administered and disposed of under the Housing Act 1955.
40. While Kāinga Ora is the default agent of the Crown under the Housing Act, this agency can be revoked by Ministerial notice.⁶ This means administrative responsibility for the homes could be transferred to HUD or contracted to another agency, such as LINZ.
41. Options for use of these homes include immediately on-selling them on the open market at the prevailing market value, holding onto the homes until prices recover (and potentially renting them in the interim to help cover the holding costs), or on-selling them for a particular use.
42. Initial discussions suggest institutional investors may be interested in purchasing a portfolio of rental properties from the Crown. Similarly, these homes could be on-sold to Community Housing Providers for use as social or affordable housing. However, some developers are concerned social housing could affect the marketability and value of other homes in their developments.
43. We will provide further advice as required, as the optimal approach will depend on the prevailing market conditions when underwrites are triggered.

Risks and mitigations

44. Sales underwrites are not without risk, which is the very reason they are needed. The main risks and mitigations are summarised in the following table.

RISKS	MITIGATIONS	COMMENTS
Crowding out other developers	<ul style="list-style-type: none"> • Provide underwrites in places where there is excess sector capacity (and a lack of housing supply). 	
Lack of incentives for developers to market homes	<ul style="list-style-type: none"> • Set underwrites at appropriate discount to the expected market value of the completed homes. 	

⁶ The process for revoking Kāinga Ora’s default agency is set out in section 2A of the Housing Act.



	<ul style="list-style-type: none"> • Vet developers' marketing plans, and set a minimum period before underwrites can be triggered post completion. 	
Underwrites are triggered	<ul style="list-style-type: none"> • Set underwrites at appropriate discount. • Acquire and on-sell (may require write-down). • Hold properties until market recovers, then on-sell (could rent in interim to offset holding costs). 	Cabinet also agreed that there would be no limits on who can buy the underwritten homes, to increase the pool of potential buyers.
Triggered underwrites exceed provisioning	<ul style="list-style-type: none"> • Underwrite developments with staggered completion dates to reduce risk coinciding with a market trough, and support capital recycling. 	
Lack of buyer constraints make satisfy the “public interest” test under the PFA harder	<ul style="list-style-type: none"> • Limit use to markets with a clear undersupply of homes, and at points in the market cycle where there is a clear surplus of sector capacity. 	The adequacy of overall housing supply has a significant bearing on both house prices and rents, as well as reducing crowding and social housing demand.
Unsuccessful applicants challenge decisions in court or public	<ul style="list-style-type: none"> • Clear and fair processes act as mitigation. 	There has never been a court case against HUD or Kāinga Ora in its application processes.
Failure of developer during the development	<ul style="list-style-type: none"> • Underwrites can only be triggered for completed homes. 	Due diligence process and assessment criteria include financial capacity.

Financial implications and appropriation changes

45. Based on current assumptions around the likelihood of underwrites being triggered, available funding within existing underwriting appropriations could underwrite up to ^{s 9(2)(g)(i)} homes at any point through the general underwrite tool.⁷
46. Funding is required to purchase homes when underwrites are triggered, which has an upfront impact on net-debt. OBEGAL impacts are limited to holding costs prior to homes being sold, and any loss should homes be sold for below the underwrite price. Revenue from on-sold properties unwinds the initial net-debt impact provided homes are on-sold at or above the purchase price.
47. HUD’s ability to administer the programme is also conditional on securing funding for programme administration and expert consultants (estimated at \$1.5 million in the first year). HUD cannot absorb these costs. ^{s 9(2)(f)(iii)}
48. We propose seeking your formal agreement to the required appropriation changes to be included in the October Baseline Update process. This will be based off the most

⁷ s 9(2)(i), s 9(2)(j)



up to date financial forecast and risks associated with BRD and KiwiBuild deals.

Consultation

49. Treasury and MBIE were consulted. Targeted, in-confidence, testing also occurred with Kāinga Ora, Residential Sector Reference Group members, and financiers.

Next steps

50. Subject to your agreement, we propose reporting back to you in late August 2024 (to support a September launch) with:
- a. A detailed implementation and communications plan for the general underwrite (building on previous experience, collateral, and lessons from KiwiBuild and BRD)
 - b. Further advice on the approach to winding down KiwiBuild (Kāinga Ora led)
 - c. Detailed financial recommendations for inclusion in the October Baseline Update
 - d. s 9(2)(f)(iv) [REDACTED]
51. We will provide further advice on any ongoing role for Government underwrites beyond the current market downturn as part of the November 2024 report back on resetting Government investment in housing and urban development.

Annexes

Annex A: Comparison with legacy programmes: KiwiBuild Underwrite and Build-Ready Developments Underwrite

Annex A: Comparison with legacy programmes: KiwiBuild Underwrite and Build-ready Developments Underwrite

Legacy programmes			
	KiwiBuild	BRD	Proposed settings for General Underwrite
Eligibility Criteria	<p>The proposed KiwiBuild homes are priced at or below the applicable KiwiBuild price caps.</p> <p>The applicant is proposing a minimum of 20 KiwiBuild homes allocated within a single development.</p> <p>The applicant owns the land, has a development agreement, or has entered into an Agreement for Sale and Purchase to acquire the land.</p>	<p>Applicant must –</p> <ul style="list-style-type: none"> • have secured ownership or use of land • be an established developer or house builder with a proven track record • ensure land has resource consent. <p>Construction of the dwellings has not yet commenced, or the stage of development has not yet commenced.</p> <p>Development contributes to increasing supply and addressing an unmet housing need in an area and there is a high risk that the development will stall or not complete without Crown support.</p>	<p>Applicant must –</p> <ul style="list-style-type: none"> • be an established developer with a proven track record of successfully building and selling comparable homes; • have secured ownership or use of the land (or an option to do so), along with any required resource consents; • provide satisfactory evidence that underwrites are needed for the development to proceed within 6 - 12 months; • be seeking support for a development (or stage of development) that will deliver at least 30 homes; and • agree to provide a recent market valuation approved by the Crown prior to any underwrite being agreed.
Assessment Criteria	<ul style="list-style-type: none"> • Developer credentials (Right Developer). • Design (Right Home) – KiwiBuild homes adhere to relevant Kāinga Ora design guides. • Location (Right Place) – area of demand for affordable housing in proximity to nearby amenities and transport links. • Financial Analysis (Right Price) – KiwiBuild Price caps, good value for money. • Other – Risks and mitigations, merits, conditions, climate impact assessment, warranties and guarantees, valuation peer review, sales, and mispricing risk review. 	<ul style="list-style-type: none"> • Contribution to increasing supply and addressing unmet housing need. • Project readiness – Evidence construction can commence within 6 – 12 months. • Cost and risk to the Crown – Evidence that a developer has finance to undertake the development subject to securing pre-sales and underwrites on acceptable terms. • Wider Government objectives for housing and urban development. • Prioritising areas with highest need as identified in PHP 2021-2024 and the locations identified through the Affordable Housing Fund. 	<p>We proposed criteria cover:</p> <ul style="list-style-type: none"> • project readiness, including expected commencement date and staging; • volume and nature of supply, including number of bedrooms; • location (including the degree of unmet housing need, projected population growth, and proximity to nearby amenities and transport links); and • net cost and risk to Crown. <p>Relative weightings to be finalised.</p>