



Briefing

OPTIONS FOR ENDING THE KIWIBUILD PROGRAMME			
To Minister	Hon Nicola Willis	Portfolio	Minister of Finance
To Minister	Hon Chris Bishop	Portfolio	Minister of Housing
Date	22/08/24	Priority	Medium
Tracking number	HUD2024-005127		
ACTION SOUGHT			
Action sought	Agree targeted changes to support the wind down of the KiwiBuild (Buying off the Plans) Programme and reduce the costs and risks associated with managing legacy underwrites.		
Deadline	29/08/2024		
CONTACT FOR DISCUSSION			
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OTHER AGENCIES CONSULTED			
The Treasury (TSY), Kāinga Ora – Homes and Communities			



RECOMMENDED ACTIONS		
It is recommended that you:		
1.	Agree to the following policy setting changes for the KiwiBuild (Buying off the plans) underwrite to reduce cost and risk to the Crown:	
a.	Remove buyer restrictions for both developers (when selling homes) and Kāinga Ora (where they acquire and on-sell homes),	<i>Agree/Disagree</i>
b.	Remove KiwiBuild price caps for homes that do not have a presale commitment from a purchaser,	<i>Agree/Disagree</i>
c.	Remove minimum occupation requirements for purchasers,	<i>Agree/Disagree</i>
d.	Allow homes to be sold at a loss where the cost of holding the properties until house prices recover exceeds the cost of selling the homes immediately, provided losses remain within the available funding for write downs/holding costs (currently \$7.6 million).	<i>Agree/Disagree</i>
2.	Note that Kāinga Ora has already been authorised to extend underwrite expiry dates, which could reduce underwriting risk for some developments by providing developers with more time to market homes.	<i>Noted</i>

Jane Keane

Jane Keane
**Manager, Urban
Development and
Infrastructure**
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Hon Chris Bishop
Minister of Housing
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Hon Nicola Willis
Minister of Finance
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Purpose

1. This briefing seeks your agreement to targeted changes to KiwiBuild settings to support its wind down, and reduce the costs and risks associated with managing legacy KiwiBuild underwrites.
2. We recommend that you read this briefing in conjunction with the related paper – *Establishing a general underwrite to maintain housing construction – implementation update* [HUD2024-005126].

Executive Summary

3. Cabinet has agreed to end the KiwiBuild Programme and Build Ready Development Pathway and move to a general underwriting programme to mitigate the current downturn in residential construction [ECO-24-MIN-0121 refers].
4. Kāinga Ora currently manages legacy underwrites for 998 homes, with a total theoretical underwrite risk exposure of \$537 million. Actual expenditure is forecast to be well below this, and within the available appropriation of \$210.618 million. However, current market conditions are increasing the risk of underwrites being triggered, with 30 percent of developments being considered “high risk.”
5. We therefore recommend targeted policy and operational changes to reduce the risk of underwrites being triggered and associated costs to the Crown.
 - a. **Remove KiwiBuild buyer restrictions** for both developers (when selling homes) and Kāinga Ora (where they acquire and on-sell homes). This will allow homes to be sold to a broader buyer pool, reducing the risk that underwrites are triggered.
 - b. **Remove KiwiBuild Price caps** for homes that do not have a presale commitment from a purchaser. This will allow developers to recoup increased construction costs that have adversely impacted commercial viability, but only to the extent that the market is prepared to pay more.
 - c. **Remove minimum occupancy requirements for purchasers** (currently one year for one bedroom properties and three years for others) to reduce the cost of monitoring compliance and processing requests for waivers.
 - d. **Allow homes to be sold at a loss** where the cost of holding the properties until house prices recover exceeds the cost of selling the homes immediately, provided losses are capped within the available funding for write downs/holding costs (currently \$7.6 million). This will allow homes acquired to be on sold as soon as practicable.
6. These setting changes will also make the KiwiBuild legacy underwrites more consistent with the general underwrite and reduce the operational and administrative costs of managing the legacy underwrites (including processing ad hoc requests for



dispensations from the minimum occupation periods and price caps on hardship grounds)

7. Annex A provides a more detailed overview of the proposed policy changes.

Background

8. As part of resetting investment in housing and urban development [ECO-24-MIN-0121 refers], Cabinet agreed to:
- end the KiwiBuild Programme and Build Ready Development pathway and move to a general underwriting programme to mitigate the current downturn in residential construction; and
 - authorise you to make any decisions reasonably necessary to give effect to these changes, drawing on the existing appropriations.
9. This briefing focuses on the targeted changes required to wind down KiwiBuild and reduce the cost and risks associated with managing legacy KiwiBuild underwrites.

Current market conditions are increasing the risk of KiwiBuild underwrites being triggered

10. On 15 August, the Reserve Bank lowered the Official Cash Rate by 25 basis points and released its latest Monetary Policy Statement (MPS). It notes that a substantial decline in residential investment is underway and is expected to continue until the beginning of 2025. High interest rates and subdued house price growth are contributing to a decline in residential construction activity, consistent with the decline in dwelling consents since mid-2022.
11. Lower interest rates and net immigration around its pre-COVID-19 average are expected to support a recovery in house prices and building activity in the second half of the Reserve Bank’s projection period.

House price growth



Source: CoreLogic, RBNZ estimates.

Official Cash Rate (OCR)

(quarterly average)




Source: RBNZ estimates.




12. The short-term downturn in residential investment forecasted supports the case for a general underwrite to maintain construction activity over the coming year, noting these homes will likely be completed against the backdrop of rising prices (reducing the underwriting risk). However, the downwards revision in short term house price expectations increases the risk of some existing KiwiBuild underwrites agreed at the market peak being triggered over coming months. It will also make it harder to on-sell KiwiBuild homes that have already been acquired by the Crown.

Overview of current KiwiBuild liabilities


13. Kāinga Ora signed their last KiwiBuild underwrites in March 2023. However, it is still managing legacy underwrites for 998 homes that are due for completion over the next three years. In the previous financial year (2023/24), 55 KiwiBuild homes were acquired by Kāinga Ora on behalf of the Crown for a total cost of \$28.2 million. Fifty-three of these homes are still held under the Housing Agency Account.

14. s 9(2)(g)(i)
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s 9(2)(g)(i)



Risk assessment under current settings

15. Kāinga Ora commissions modelling of underwriting risks from Taylor Fry every two months. The latest modelling, as at 30 June 2024, suggests that under current policy settings:
- 30% of the developments in the portfolio are at high risk of underwrites being triggered (mostly concentrated in Auckland), with a further 33% considered medium risk.
 - s 9(2)(i), s 9(2)(j)
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c. s 9(2)(i), s 9(2)(j)

d. s 9(2)(i), s 9(2)(j)

16. More detail on the KiwiBuild Pipeline and Crown risk exposure can be found in Annex B.

Reducing underwriting risks and costs through targeted policy changes

17. To reduce the underwriting risk and cost to the Crown, we recommend:
- a. **Removing buyer restrictions** - for both developers (when selling homes) and Kāinga Ora (where they acquire and on-sell homes), which will also remove the alternative buyer hierarchy for Kāinga Ora. This will allow homes to be sold to a broader buyer pool, reducing the risk that underwrites are triggered and supporting faster on-sales where they are.
 - b. **Removing KiwiBuild price caps** - for homes that do not have a presale commitment from a purchaser. This will allow developers to recoup the high cost of construction but only to the extent that the market is prepared to pay more in the context of high interest rates.
 - c. **Removing minimum occupation periods** – of three years (one year for one beds) to reduce the cost of monitoring compliance with minimum occupation period and processing requests for waivers.
 - d. **Selling homes at a loss** - where the operating losses from holding the properties until house prices recover is likely to exceed capital losses from selling the homes immediately, provided losses remain within the available funding for write downs/holding costs (currently \$7.6 million). This will allow homes that are acquired to be on sold as soon as practicable, reducing holding costs for the Crown.
18. These setting changes will also make the KiwiBuild legacy underwrites more consistent with the general underwrite.
19. Note that you have previously authorised Kāinga Ora, where requested, to extend underwrite timeframes to allow developers to take more time to market homes before having to decide whether to trigger the underwrite. Extending the underwrite provides surety and reduces the risk of the underwrite being triggered.

Estimating the collective impact of the proposed setting changes

20. Our expectations are that the proposed setting changes will:



- a. Reduce risk for homes due to be delivered from 2025 onwards due to a combination of the ability to market to a broader buyer pool and recovering house prices from 2025 onwards as indicated by RBNZ forecasts above.
- b. Have less impact on some existing KiwiBuild underwrites agreed at the market peak being triggered over coming months ^{s 9(2)(g)(i)} [redacted] due to the downwards revision in short term house price expectations.

Administrative arrangements

- 21. As per the advice provided *Establishing a general underwrite to maintain housing construction – implementation update* [HUD2024-005126 refers], we recommend that consideration of transferring the KiwiBuild legacy to HUD be deferred while the general underwrite is established. This will provide time to understand how the setting changes will affect the cost to administer the existing legacy contracts (including wind down costs) and how appropriations and administrative functions can be streamlined.

Financial implications

- 22. The policy options presented will reduce the administrative costs of the KiwiBuild legacy underwrite deals by reducing the cost of monitoring compliance with minimum occupation periods.
- 23. Any further financial implications of these policy setting changes will be addressed in future advice which will include detailed information on changes to the existing KiwiBuild appropriations necessary to establish the Residential Development Underwrite.

Risks and mitigations

- 24. Detail on the KiwiBuild Pipeline and Crown risk exposure can be found in Annex B. The main risks and mitigations associated with the policy setting changes are summarised in the following table:

RISK	MITIGATION	COMMENT
Homes are purchased by the Crown at above true buyer value	Broadening the buyer pool will reduce the risk of underwrites being triggered.	Buyer demand is also expected to return in the next 18 months. The likelihood that homes delivered beyond the next 12-18 months are on-sold at a loss is low.
Potential to artificially increase house prices by removing price caps (a fixed pre-purchase price could have downward pressure on house prices)	The legacy underwrites don't support developments at a scale large enough to increase house prices in areas where underwrites are triggered.	House prices are currently stagnant and not expected to start rising until 2025.



Potential for developers to get windfall gains from removal of price caps	We don't consider windfall gains likely due to the current economic climate, high interest rates, and high construction costs over the previous 18-24 months.	
Removing occupancy requirements hinders developers' ability to sell homes quickly (due to initial sales competing with resales)	Broadening the buyer pool so that 100% of developments can be sold on the market will improve ability to sell. The two-year brightline test will also mitigate this.	Occupancy requirements could be reduced to one year instead of being removed, as a middle ground option (see Options on policy settings above).
KiwiBuild developers become insolvent because of the implications of market dynamics	Kāinga Ora's due diligence checks on developers.	

Consultation

25. The Treasury has been consulted on, and its feedback reflected in, this paper. In particular, given ongoing uncertainty around wind-down costs associated with administration of legacy contracts and closing of the programme, Treasury is supportive of Kāinga Ora retaining administrative responsibility for KiwiBuild legacy underwrites at this time.
26. Kāinga Ora – Homes and Communities have been consulted on the policy options presented.

Next steps

27. If you agree to the policy options proposed:
 - a. Kāinga Ora will prepare waivers to remove the requirements for developers and purchasers, making the settings more consistent with the general underwrite and reducing the cost and risk to the Crown.
 - b. Kāinga Ora and HUD will prepare a Communications Plan to manage the closure of the KiwiBuild brand and transition to the new general underwrite.
28. We will report back on changes to KiwiBuild appropriations in future advice.

Annexes

Annex A: Detailed information on policy setting changes and other cost and risk mitigations

s 9(2)(b)(ii)

Annex A: Detailed information on policy setting changes and other cost and risk mitigations

Policy setting	Context	Proposed change	Rationale and expected impact
<i>Mitigations through policy setting changes</i>			
Buyer restrictions	Current settings only allow 15% of homes to be sold on the open market. KO can sell homes to PHO providers, iwi/Māori, CHPs or KO PH after failing to sell to eligible buyers.	Remove buyer restrictions for both developers and (where they acquire properties) Kāinga Ora. This will remove the buyer hierarchy for KO (FHBs – PHO – Iwi/Māori – CHPs – KO PH).	<ul style="list-style-type: none"> Will enable developers and Kāinga Ora to market to a broader buyer pool, reducing the risk to the Crown of underwrites being triggered and making it easier and quicker for the Crown to on sell homes. Additionally, it will allow the programme to support a broader range of households (including downsizers therefore freeing up bigger homes for other families) and tenants.
Price caps	Current settings require homes to be sold at the KiwiBuild price caps.	Remove KiwiBuild price caps for homes that do not have a presale commitment from a purchaser	<ul style="list-style-type: none"> Unprecedented construction costs have squeezed developers' margins. This has resulted in developers approaching Kāinga Ora seeking dispensation from KiwiBuild price caps to offset these increases. Removing the caps will allow developers to offset these unexpectedly high construction costs, reducing the risk of financial stress and company failures, but only to the extent that the market is prepared to pay more in the context of high interest rates. Remove the cost of request to process price cap waivers.
Minimum occupation period	Current settings require buyers to live in the home for a minimum of one year for one bedroom homes and three years for homes with two or more bedrooms.	Remove minimum occupation period Alternative option would be to shorten the minimum occupation period to one year which would help alleviate developer concerns around market saturation. HUD would not recommend this option.	<ul style="list-style-type: none"> Reduce the cost of monitoring compliance with minimum occupation period and processing requests for waivers on the grounds of unforeseen circumstances and financial hardship. The original intent behind the minimum occupation period was to reduce the likelihood of people receiving windfall gains by on selling. This is much less likely in the current environment, given house price falls.
Selling homes at a loss	Residential housing market may result in some homes being acquired at an underwrite price above true value of the homes.	Allow homes to be sold at a loss where the operating losses from holding the properties until house prices recover is likely to exceed capital losses from selling homes immediately, provided losses remain within the available funding for write downs/holding costs (currently \$7.6 million).	<ul style="list-style-type: none"> This will allow homes that are acquired to be on sold as soon as practicable. The likelihood of homes that are delivered in 12-18 months being sold at a loss is low. This will reduce holding costs to the Crown and mitigate the risk of having new homes sitting empty during a housing shortage
<i>Other operational mitigations</i>			
Extending underwriting timeframes	Ministers have given KO discretion to extend sunset clauses on KiwiBuild underwrites on a deal-by-deal basis.	Note that where requested, KO can allow developers to take more time to market homes before having to decide whether to trigger the underwrite	<ul style="list-style-type: none"> Some developers would like to slow down their developments or extend their marketing periods so that they have more time to find someone willing to purchase the home above the underwrite price, but they still need the security of being able to trigger the underwrite if that doesn't succeed.



s 9(2)(b)(ii)



