Te Tūāpapa Kura Kāinga
Ministry of Housing and Urban Development

TE TAI ŌHANGA
THE TREASURY

# Joint Report: Kāinga Ora Spending, Funding, and Financing Review – Cost to Build

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|---|---|---|---|
| **Date:** | 01 September 2023 | **Report No:** | T2023/1416<br>HUD2023-002977 |
| | | **File Number:** | SH-18-1-1-1 |

## Action sought

| | Action sought | Deadline |
|---|---|---|
| **Minister of Finance**<br>(Hon Grant Robertson)<br><br>**Minister of Housing**<br>(Hon Dr Megan Woods) | **Note** that the Project Team now has a reasonable understanding of total capitalised costs over recent years and how these compare to the cost assumptions underpinning the Kāinga Ora Long Term Investment Plan (LTIP) and Budget processes.<br><br>**Agree** that Kāinga Ora develop and submit a plan in late 2023 to improve its information systems and data capability. | 4 September 2023 |

## Contact for telephone discussion (if required)

| Name | Position | Telephone | | 1st Contact |
|---|---|---|---|---|
| Emily Pearse | Project Lead - Kainga Ora Spending, Funding and Financing Review | N/A (wk) | s 9(2)(a) (mob) | ✓ |
| Geraldine Treacher | Manager Housing and Urban Growth | s 9(2)(a) (wk) | s 9(2)(a) (mob) | |
| Glenn Phillips | Head of Crown Entity Monitoring and Performance | s 9(2)(a) (wk) | s 9(2)(a) (mob) | |

## Minister's Office actions (if required)

| |
|---|
| Return the signed report to Treasury. |

**Enclosure**: No

# Joint Report: Kāinga Ora Spending, Funding, and Financing Review – Cost to Build

## Executive Summary

As part of Budget 2023, borrowing and operating funding was provided to deliver Government commitments, including:

a. $3.1 billion of borrowing for the Kāinga Ora portion of the 3,000 additional public housing places by June 2025 including an allowance for renewal activity to offset demolitions to reach the net target.

b. Approximately $4 billion of borrowing up to June 2024 to meet the previous public housing commitment including an allowance for renewal activity to reach the net target.

The broad financial assumptions that informed the Budget 2023 decisions were derived from the Kāinga Ora Long-Term Investment Plan (LTIP) model and included:

a. Up to $760,000 capital expenditure per new build (both additional and renewal), and

b. Approximately $60,000 per new build per annum to operate[1] each unit on an ongoing basis.

The Kāinga Ora Spending, Funding and Financing (SFF Review) is validating the key assumptions in the LTIP model and the level of borrowing that was set aside in Budget 2023 with actual Kāinga Ora cost information.

**Average total capitalised costs per unit: FY2022/23**

The Project Team now has a reasonable understanding of total capitalised costs (i.e. the total of build and non-build costs) over recent years (Table 1 refers), and how these compare to the cost assumptions underpinning the LTIP and Budget decisions.

At a high-level, analysis shows that in FY2022/23:

a. Total capitalised costs for Kāinga Ora redevelopments (which do not include the cost of acquiring land) generally cost less than budgeted for based on recent actuals.

b. Developer-led projects cost less than budgeted for and less than redevelopments when land costs are excluded (in order to provide a more direct comparison with redevelopments).

**Table 1:** Validated actual costs of public housing – FY2022/23

| Category | FY21/22 | FY22/23 | Number of Assets | Total Capitalised Spend | Cost |
|---|---|---|---|---|---|
| Maintenance and Asset Management | ✓ | | 70,000 homes | $1.1 billion | $15,300 per property per annum |
| Customer Programme and Tenancy Support | ✓ | | 70,000 tenancies | $0.23 billion | $3,800 per tenancy per annum |
| Total capitalised costs - Redevelopments (excluding land costs) | | ✓ | 1,381 units | $0.84 billion | $609,190 per unit |

[1] This includes maintenance and asset management, property management and tenancy services, retrofit and complex remediations, and interest expenses.

| Category | FY21/22 | FY22/23 | Number of Assets | Total Capitalised Spend | Cost |
|---|---|---|---|---|---|
| Total capitalised costs - Developer-led projects (including land costs) | | ✓ | 1,080 units | $0.84 billion | $774,598 per unit |
| *Total capitalised costs - Developer-led projects (excluding land costs)* | *This figure is based on a smaller subset of 54 per cent of total units for developer-led projects in FY2022/23* | | | | *$574,060 per unit* |

**External validation of build costs - independent quantity surveyor analysis**

To provide external validation of the costs associated with new public homes, Kāinga Ora engaged an external quantity surveyor to:

a. Estimate the build cost of new public homes (by size and typology), and

b. Compare that cost to a modest market home (i.e., KiwiBuild).

This exercise concluded that Kāinga Ora build costs are marginally higher than a *modest market home* due to build features associated with Kāinga Ora requirements and 'public good' policy decisions in providing higher quality public housing. Given this external validation of build costs, the Project Team is now wanting to better understand non-build costs.

**How these numbers compare to Budget 2023 funding and next steps**

To complete the process of validating the level of borrowing set aside for Budget 2023 the Project Team is now working to understand:

a. The split of build costs to non-build costs (the LTIP model assumes a split of 51 per cent build costs to 49 per cent non-build costs), including capitalised costs that are incurred prior to construction.

b. Kāinga Ora operating costs (including overheads).

c. Valuation methodologies for Developer-led projects, and the value-for-money that these deliver.

The Project Team will undertake a bottom-up validation approach utilising the FY2022/23 analysis and enhancing this with information that can be provided from contracts that have been entered into for delivery in FY2023/24 and FY2024/25.

Once completed, this analysis will also allow the Project Team to provide an estimate of total interest costs incurred (i.e. the largest component of the Budget 2023 operating assumption of $60,000 per new build per annum).

**Data and System Limitations**

Kāinga Ora have supported the SFF Review with the information that they have, but several gaps have been identified that could be filled to give more transparency and assurance and support better decision making. This finding follows the Department of Prime Minister and Cabinet's recommendation that Kāinga Ora take immediate actions to strengthen its information systems.

It is recommended that Kāinga Ora develop a plan for consideration in late 2023 by the Minister of Finance and the Minister of Housing that addresses current data and system limitations, in order to be able to provide a better understanding of costs.

**Final Report**

A Final Report is expected to be provided to Ministers in late 2023 to support Budget 2024 processes.

## Recommended Action

We recommend that you:

*Total Capitalised Costs*

a **note** that the Project Team now has a reasonable understanding of total capitalised costs over recent years, and how these compare to the cost assumptions underpinning the Kāinga Ora Long Term Investment Plan (LTIP) and Budget processes. In FY2022/23, analysis shows that at a high-level:

i. Kāinga Ora redevelopments (which do not include the cost of acquiring land) generally cost less than budgeted for.

ii. Developer-led projects cost less than budgeted for and less than redevelopments when land costs are excluded (in order to provide a more direct comparison with redevelopments).

*Independent Quantity Surveyor Analysis*

b **note** that an independent quantity surveyor has assessed Kāinga Ora build costs, which are marginally higher than a *modest market home* due to build features associated with Kāinga Ora requirements and 'public good' policy decisions in providing higher quality public housing.

c **note** that given this external validation of build costs, the Project Team is looking to better understand non-build costs.

*Validating the level of borrowing set aside for Budget 2023*

d **note** that to complete the process of validating the level of borrowing set aside for Budget 2023 the Project Team is working to understand:

i. The split of build costs to non-build costs. This will include extracting capitalised costs that are incurred prior to construction.

ii. Kāinga Ora operating costs (including overheads).

iii. Valuation methodologies for Developer-led projects, and the value-for-money that these projects deliver.

e **note** that once completed, this analysis will allow the Project Team to provide an estimate of total interest costs (i.e. the largest component of the Budget 2023 operating assumption of $60,000 per new build per annum).

*Final Report*

f **note** that the outcomes of the Spending, Funding and Financing (SFF) Review are expected to be provided to Ministers in late 2023 along with:

i. A greater understanding of current levels of expenditure, assurances around total costs and what that might mean for debt requirements over coming years, and different purchasing options in order to better manage the fiscal outlook.

ii. Advice assessing whether the Kāinga Ora funding and financing model is efficient, fit for purpose, provides value-for-money, is sustainable and supports the delivery of the Government's housing objectives and commitments.

*Data and System Limitations*

g **note** while Kāinga Ora has provided a range of information to support the SFF Review, improvements are required to the way asst cost data and project management information is recorded and linked across the organisation to improve cost visibility.

h **Agree** that Kainga Ora develop and submit a plan by late 2023 to improve its information systems and data capability in order to better understand costs, support good decision making, and provide assurance.

*Agree / Disagree*
*Minister of Finance*

*Agree / Disagree*
*Minister of Housing*

Geraldine Treacher
**Manager Housing and Urban Growth**
The Treasury

Glenn Phillips
**Head of Crown Entity Monitoring and Performance**
Ministry of Housing and Urban Development

Hon Grant Robertson
**Minister of Finance**

_____/_____/_______

Hon Dr Megan Woods
**Minister of Housing**

_____/_____/_______

# Joint Report: Kāinga Ora Spending, Funding, and Financing Review – Cost to Build

## Purpose of Report

1. This report provides an update on progress on the Kāinga Ora Spending, Funding and Financing Review (the SFF Review), including:
    a. The cost to build public housing over recent years.
    b. Linking the cost to build public housing to Budget 2023 assumptions.
    c. How this links to work previously undertaken by the SFF Review Project Team.
    d. Next Steps for the SFF Review, including
        i. Validating build costs vs. non-build costs.
        ii. Validating operating costs (including overheads).
        iii. Validating methodologies for Developer-led projects, and the value-for-money that these projects deliver.
        iv. Comparing what has been provided through the Budget process to provide an overview of any expected difference and implications for the Government's overall fiscal position.

## Budget 2023

2. As part of Budget 2023, borrowing and operating funding was provided to deliver Government commitments including:
    a. $3.1 billion of borrowing for the Kāinga Ora portion of the 3,000 additional public housing places by June 2025 including an allowance for renewal activity to offset demolitions to reach the net target.
    b. Approximately $4 billion of borrowing up to June 2024 to meet the previous public housing commitment including an allowance for renewal activity to reach the net target.
3. At an individual unit level, the broad financial assumptions included:
    a. Up to $760,000 per new build (both additional and renewal),
    b. The procurement of land additional to current State land holdings to enable new builds (value is dependent on the location of land), and
    c. Approximately $60,000 per new build per annum to operate[2] these places on an ongoing basis.
4. These figures were derived from the Kāinga Ora Long-Term Investment Plan (LTIP) model, which assumed the following average costing excluding capitalised overheads across typologies (Table 1 refers).

[2] This includes maintenance and asset management, property management and tenancy services, retrofit and complex remediations, and interest expenses.

s 9(2)(f)(iv) [redacted]

5. The Kāinga Ora Spending, Funding and Financing (SFF Review) is looking to validate the key assumptions in the LTIP model and the level of borrowing that was set aside in Budget 2023 with actual Kāinga Ora cost information.

## Work already completed by the SFF Review Project Team

6. An initial update on progress of the SFF Review was provided to Joint Ministers in July [T2023/1385, HUD2023/002680 refers]. This provided an overview of validated costs associated with the provision of public housing including costs associated with:

   a. Maintenance and asset management, and

   b. Customer programme and tenancy support.

**Table 2:** Summary of validated public housing costs – FY2021/22

| Category | Number of Assets | Total Spend FY22 | Cost |
|---|---|---|---|
| 1. Maintenance and Asset management [3] | 70,000 homes | $1.1 billion | $15,300 per property[4] |
| 2. Customer Programme and Tenancy Support [5] | 70,000 tenancies / 200,000 customers | $0.23 billion | $3,700 per tenancy |

## Validating the capitalised costs per unit

7. Total Capitalised Costs for public housing units include both:

   a. Build costs (e.g., foundation, framing, cladding and fit out), and

   b. Non-build costs: including making land build ready; Consenting and Development Constructions; Site works and utilities; and Management, Contingency and GST.

8. The following analysis provides an overview of total capitalised costs in FY2022/23 split by redevelopment and new acquisitions[6].

### Process for validating assumptions against actual capitalised costs

9. The Project Team has been working with Kāinga Ora to understand actual total capitalised costs over recent years to compare LTIP and budget assumptions.

10. Kāinga Ora records cost information at the project level (rather than at the individual home level) making the process of comparing actuals to Budget assumptions challenging. Adding to this complexity, projects are often split across multiple financial years, have mixed unit typologies and varying bedroom numbers. This further complicates the process of extrapolating and validating unit-level cost information.

[3] Direct asset management costs include total cost to operate a home including maintenance costs, rates, and people enabling these services. Overhead costs include functional areas supporting specific direct groups, leaderships teams, and overheads.
[4] Delivery of Health Homes increased expenses in 2022 above core maintenance of $7,700 per property.
[5] Direct costs include front facing customer and delivery group. Overhead costs include functional areas supporting specific direct groups, leaderships teams, and overheads.
[6] Total sample size of redevelopment and new build acquisition of 2,461 units

11. To identify unit-levels costs, Kāinga Ora has undertaken a matching exercise linking various asset management and project management datasets with accounting system information to develop a per-unit cost by typology and number of bedrooms.[7]

12. This matching exercise provides a sample size that accounts for around 88 per cent of projects that Kāinga Ora has delivered in FY 2022/23.

13. It is important to note timing issues impact when project costs are recorded over the financial year, and this timing issue sits against a backdrop of high cost inflation.

## Average Total Capitalised Costs per unit: FY2022/23

*Redevelopments*

14. Redevelopment generally refers to the process of demolishing an existing public home which has reached the end of its economic life and then rebuilding. Depending on whether the land and community is suitable, redevelopment may result in replacing the home with more than one new property. Kāinga Ora manages the redevelopment, and in some situations, this involves works to make the land suitable. Kāinga Ora advise that their landholdings can be lower quality or more complex to build on than market land.

15. The Project Team identified 1,381 individual units in FY2022/23 with near-complete cost information at a total cost of $841 million. The average total capitalised cost of these units by size and typology is shown in Table 3 below. All cost averages include capitalised overheads expect for the LTIP benchmark.

**Table 3:** FY2022/23 Redevelopment actuals by typology and size compared to LTIP [8,9]

s 9(2)(f)(iv)

*Developer-led Projects*

16. Developer-led Projects (new and existing) refer to the purchase of new or existing homes from private developers or owners for use as a public . They have become an increasingly large part of the Kāinga Ora pipeline. Developer-led projects include the cost of land and build (i.e., complete houses) and developer's/builder's margins. Kāinga Ora often purchases these as 'turnkey' properties and developers manage the build.

17. The Project Team identified 1,080 individual developer-led projects with near-complete cost information were identified in FY2022/23 at a total cost of $837 million. The average total capitalised cost of these units by size and typology is shown in Table 4 below.

[7] Because costs are recorded at the project level, proportional estimates have been applied.
[8] Where cells are empty, less common typologies were not delivered within FY2022/23
[9] These figures may increase marginally (i.e. by less than 10 per cent) as final invoices are paid before being capitalised
[10] LTIP figures informing Budget requirements are escalated by 10.9% in FY2023/24 and 5.5% in 2024/25

s 9(2)(ba)(ii)

[redacted]

18. To understand value-for-money and compare redevelopment costs with new build acquisition costs on a like-for-like basis the Project Team is looking to understand the intrinsic value of the land component of acquire new costs.

19. Initial analysis against a reduced sample size (Table 5 refers) shows that, on average, Kāinga Ora redevelopments ($609,190) cost an average of $35,000 more than developer-led acquisitions ($574,000) when the cost of land is excluded.

s 9(2)(ba)(ii)

[redacted]

**How these numbers compare to Budget 2023 funding**

20. At a high-level, analysis shows that in FY2022/23:

    a. Kāinga Ora redevelopments (which do not include the cost of acquiring land) generally cost less than budgeted for.

    b. Developer-led projects cost less than budgeted for and less than redevelopments when land costs are excluded (in order to provide a more direct comparison with redevelopments).

**Table 6:** FY2022/23 Average redevelopment and new build acquisition (excluding and including land value) actuals compared to LTIP

s 9(2)(ba)(ii)

[redacted]

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[11] These figures may increase marginally (i.e. by less than 10 per cent) as final invoices are paid before being capitalised.
[12] LTIP figures informing Budget requirements are escalated by 10.9% in FY2023/24 and 5.5% in 2024/25.
[13] Averages presented are dependent on the weighted bedroom average for each build type and acquisition method, which will contribute to the difference in price.
[14] These figures are based on a small subset of 54 per cent of total units for developer-led projects in FY2022/23.

21. With developer-led projects expected to be a significant proportion of delivery of coming years, the Project Team will undertake further work to better understand valuation methodologies and the value-for-money that these projects deliver.

## How Kāinga Ora build costs compare to the market – quantity surveyor analysis

22. To provide external validation of the costs associated with new public homes (by size and typology) Kāinga Ora engaged an independent quantity surveyor (QS) to:

    a. Estimate the build cost of new public homes (by size and typology), and

    b. Compare that cost to a modest market home (i.e., KiwiBuild).

23. Analysis from the independent QS showed that build costs for public homes are marginally higher than a modest market (KiwiBuild) home, largely reflecting the cost of build features, components and specifications associated with Kāinga Ora requirements and policy decisions intended to provide higher quality public housing.

24. It is likely that higher level design choices (such as typology, bedroom configuration, gross floor area, land utilisation and common areas/parking) drive greater inherent cost differences relative to the market than the building components picked up in the QS analysis. Factors such as wall-to-floor ratios and the choices of typology to best utilise available land area may be significant, and these differences will be more challenging to pick up via QS analysis. More work is needed by Kāinga Ora to understand costs of providing particular typologies, configurations and land utilisation in a standardised way across the public housing portfolio (Attachments 1 and 2 refer).

25. Given the work undertaken by the QS validating Kāinga Ora build costs with those of the market, the Project Team is wanting to better understand non-build costs.

## Next Steps

**How these numbers compare to Budget 2023 funding**

26. Given the size of the Kāinga Ora capital investment pipeline and the government's current fiscal position, the Project Team is looking to provide Ministers with assurances around total costs and what that might mean for debt requirements over coming years.

27. To complete the process of validating the level of borrowing set aside for Budget 2023 the Project Team is now working to understand:

    a. The split of build costs to non-build costs (the LTIP model assumes a split of 51 per cent build costs to 49 per cent non-build costs), including capitalised costs that are incurred prior to construction.

    b. Kāinga Ora operating costs (including overheads).

    c. Valuation methodologies for Developer-led projects, and the value-for-money that these deliver.

28. The Project Team will undertake a bottom-up validation approach utilising the FY2022/23 analysis and enhancing this with information that can be provided from contracts that have been entered into for delivery in FY2023/24 and FY2024/25.

29. Once completed, this analysis will also allow the Project Team to provide an estimate of total interest costs incurred (i.e. the largest component of the Budget 2023 operating assumption of $60,000 per new build per annum).

**Final Report**

30. The outcome of this work is expected to be provided to Ministers in late 2023 to support Budget 2024. The Final Report is aiming to provide:

    a. A greater understanding of current levels of expenditure, assurances around total costs and what that might mean for debt requirements over coming years, and value different purchasing options in order to better manage the fiscal outlook.

    b. Advice assessing whether the Kāinga Ora funding and financing model is efficient, fit for purpose, provides value for money, is sustainable and supports the delivery of the Government's housing objectives and commitments.

## Progressing work to support better information systems and understanding of costs

31. While Kāinga Ora has provided a range of information where it is available to support the SFF Review, the Treasury is of the view that information available to support an understanding of actual cost is not at an adequate level to support good decision making or provide assurances to Ministers.

32. For example, the matching exercise that has been undertaken to understand actual costs has taken substantial time and requires manual matching of information from different sources and through a number of systems. Given the size of Kāinga Ora's capital investment pipeline this information should be readily available in order to understand actual costs, and how this compares to funding that has been allocated and approved.

33. The Treasury understands that Kāinga Ora is in the process of establishing a programme of work to enhance analytics relating to the cost of building public housing. This is likely to take several years to be fully implemented and operational.

34. Given the system limitations identified, it is recommended that Kāinga Ora develop and submit a plan to Joint Ministers in late 2023 that addresses these shortcomings in its information systems and supports better information collection and understanding of costs.

**DPMC recommended that Kāinga Ora take immediate actions to strengthen its information systems.**

35. Observations around the limitations of Kāinga Ora's systems are consistent with those identified by the Department of Prime Minister and Cabinet's Implementation Unit's (IU's) in its report – *Stocktake of Kāinga Ora Public Housing Construction Pipeline and Delivery* (DPMC-2022/23-599) which recommended Kāinga Ora take immediate actions to address risks and strengthen its information systems, and develop a more systematic approach to areas where it could intervene or adapt its practice to accelerate delivery.

36. The Treasury also understands that enhancements to the Kāinga Ora Pipeline are in the final stages of testing prior to final release in early 2024, and is expected to address the recommendations from the IU report. This new tool will enhance insight from the Pipeline, helping to understand aspects like project status timelines, progress against earlier estimates, and ensuring all of the major home delivery activities are captured.

s 9(2)(f)(iv)

## **Attachment 2**: Overview of cost associated with higher Kāinga Ora build specifications: QS Estimates[15]

| Cost Driver | 1 bed Standalone | 2 bed Terrace | 3 bed Standalone | 4 bed Standalone | 5 bed Standalone | 3 level Walk-up |
|---|---|---|---|---|---|---|
| KiwiBuild | $172,000 | $193,000 | $265,000 | $359,000 | $439,000 | $239,000 |
| Kāinga Ora | $193,000 | $204,000 | $322,000 | $379,000 | $399,000 | $283,000 |
| Difference | +$21,000 | +$11,000 | +$57,000 | +$20,000 | -$40,000 | +$44,000 |

s 9(2)(ba)(ii)

[redacted]