



Briefing

Targeted Changes to KiwiBuild Settings due to Covid-19

Date:	1 May 2020	Security level:	In Confidence
Priority:	Medium	Report number:	BRF19/20040631

Action sought		
	Action sought	Deadline
Hon Dr Megan Woods Minister of Housing	Agree to targeted changes to KiwiBuild settings in response to Covid-19 Note that some of these changes will require Cabinet endorsement Forward a copy of this advice to the Minister of Finance for approval.	Before end of May

Contact for discussion			
Name	Position	Telephone	1 st contact
Brad Ward	Deputy Chief Executive, Place based Policy & Programmes, Ministry of Housing and Urban Development	s9(2)(a)	✓
Caroline McDowall	Acting Deputy Chief Executive (Joint) Urban Development – Delivery, Kāinga Ora	s9(2)(a)	
Hannah McGregor	Senior Policy Advisor, Ministry of Housing and Urban Development	s9(2)(a)	
Other agencies consulted			
The Treasury, Ministry of Social Development, and the Department of Prime Minister and Cabinet were consulted			

Minister's office to complete

- ☐ Noted
- ☐ Seen
- ☐ Approved
- ☐ Needs change
- ☐ Not seen by Minister
- ☐ Overtaken by events
- ☐ Declined
- ☐ Referred to (specify)

Comments

Date returned to HUD:



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Targeted Changes to KiwiBuild Settings due to Covid-19

For: Hon Dr Megan Woods, Minister of Housing

Date: 1 May 2020

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Purpose

1. This briefing seeks your direction on targeted changes to the policy and operational settings for KiwiBuild to respond to the immediate impacts of COVID-19 with the objective of maintaining construction sector capacity, capability and momentum, and the drive to improve housing affordability, particularly for first home buyers. Some of these decisions will need Cabinet agreement.
2. The recommendations could be implemented as a package or individually. In terms of timing for decisions, you could make the changes now or wait until you receive further advice in two weeks on additional market intelligence the Ministry of Housing and Urban Development (HUD) and Kāinga Ora have received from the sector. This advice will provide a snap-shot of the current scale of the impact and how the sector is responding.
3. We recommend that any agreed changes from this paper be reviewed in six months when the impact of Covid-19 on the residential construction sector should be clearer.
4. This advice builds on the advice to Ministers Woods on supporting the residential construction sector [*Residential Construction and Covid-19* HUD BRF19/20040623].

Executive Summary

5. The residential construction sector is particularly vulnerable to economic downturns and demand shocks. It has a history of pronounced boom-bust cycles where activity, capacity and skills exit quickly but return slowly. This means that even when the economy recovers from a shock, house-building activity usually lags demand for many years, reducing supply, and increasing house prices.
6. While we do not yet know the scale of the impact of Covid-19, it has changed the cost and risk profile of residential development and construction. We are hearing from the sector that development finance is becoming harder and more costly to obtain.

7. This is particularly the case for higher-density developments with banks and finance companies now requiring a higher proportion of pre-sales, and confirmation that people who have already committed to pre-sales are still in a position to settle¹. Buyer demand also appears to be less certain². Construction companies, most notably Fletcher Building, have started reducing salaries and staff.
8. The KiwiBuild Programme can help to retain some construction sector capacity, capability and momentum by sharing some of the increased costs and risks with the private sector. This will require targeted changes to the current programme settings – both to provide more support and certainty to the sector – and to manage the Crown’s increased exposure to sales risk at a time when fewer eligible households may be less willing and able to purchase KiwiBuild homes, due to a range of factors, including reduced incomes, KiwiSaver balances, more stringent lending criteria and job security. Maintaining the momentum of the KiwiBuild programme will ensure it continues to supply affordable housing for first home buyers and others.
9. To provide more support and certainty to the sector, and to encourage the continued supply of KiwiBuild housing, we propose that the Crown agree to accept a higher degree of risk in developments where appropriate, including by:
 - a. being prepared to underwrite a higher proportion of KiwiBuild homes and providing higher value underwrites with lower discounts to market;
 - b. increasing the use of other Buying Off the Plans tools, such as outright purchase commitments; and
 - c. reducing developers’ capital requirements under the Land for Housing programme by paying for upfront project works, including planning, consenting, earthworks and other land investment, that can then be capitalised into land value and recouped when the land is on-sold.
10. To mitigate the risks that the Crown³ will own more KiwiBuild homes, and that the underwrite will become too risky (and therefore too expensive) to offer in most developments, we propose that Ministers seek Cabinet agreement to:

¹ Many developers are anecdotally reporting this, for example, an apartment development of 93 homes, with 44 underwritten as KiwiBuild, has lost its bank finance.

² [REDACTED] s18(d) [REDACTED]

³ The Crown is the owner of KiwiBuild homes, even though Kāinga Ora administers the initiative.

- a. expand the definition of an eligible purchaser to include existing home-owners who need to relocate due to the impact of Covid-19, provided that they meet the other eligibility criteria, and if they will only own one home after their sale and purchase transactions are completed;
- b. allow KiwiBuild homes to be sold to other purchasers, provided reasonable attempts⁴ have been made to sell KiwiBuild homes to eligible purchasers in the first instance, and Community Housing, Progressive Home Ownership providers or Kāinga Ora in the second instance, without having to seek prior consent from Cabinet; and
- c.

s9(2)(f)(iv)

- 11. Some of the changes to policy settings and decisions on funding arrangements will require Cabinet approval, as indicated in the recommendations and advice. We believe that the financial impact of the proposed changes can be met from within the existing \$2.1 billion funding envelope established for the KiwiBuild Programme in 2017.
- 12. We propose any setting changes are reviewed after six months' time when the government will have better information on residential construction, the housing market and other critical indicators such as employment. We intend to provide you with regular updates from our market intelligence exercise with the next update to be provided in two weeks' time. This will provide on-the-ground real-time information on the impact of the Covid-19 on the sector and housing supply, additional to the market information we have included in Annex B.
- 13. You may like to wait until you have this next update before you make any decisions on the proposals in this paper. However, waiting until we have better data and intelligence risks delivering changes to settings too late to make a meaningful impact on keeping the Programme's construction activity going and people in jobs, and ensuring there is some continued supply of new, affordable housing for first home buyers.
- 14. The specific commercial terms of contracts with developers will still need to be agreed by joint Ministers on a case by case basis.

⁴ The minimum marketing period varies from development to development, but reasonable attempts means at least the period up to the point where the developer may serve Kāinga Ora a notice of an intention to exercise the underwrite.

Recommended actions

15. The Ministry of Housing and Urban Development recommends that you:

**Minister of
Finance**

**Minister of
Housing**

- i. **note** these targeted changes are proposed in response to Covid-19 and we recommend they be reviewed in six months as the nature and scale of the impact of Covid-19 on residential construction becomes clearer, including through lagging data e.g. building consent volumes;
- ii. **note** that the proposals outlined below are about both supporting the residential construction sector from the impact of Covid-19 and mitigating the risk of the Crown holding properties that it cannot sell;

Supporting the residential construction sector by sharing more costs and risks

- iii. **agree** in the short-term the Crown may take on a higher degree of risk by providing higher value underwrites with lower discounts, increasing the proportion of homes it underwrites within developments, and increasing the use of pre-purchase commitments (as opposed to requiring developers to try to sell the properties); YES / NO YES / NO
- iv. **note** Ministers will still be asked to agree commercial underwrite terms on a case by case basis;

Supporting construction through upfront payments (no Cabinet decisions required)

- v. **agree** that the Land for Housing Programme may support developers with cashflow and feasibility by paying for upfront project works, including planning, consenting, earthworks and other land investment, that can then be capitalised into land value and recouped when the land is on-sold; YES / NO YES / NO

Expanding the eligible cohort (Cabinet decisions required)

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|---|----------|----------|
| vi. agree to expand the definition of eligible KiwiBuild purchasers (currently limited to first home buyers and 'second chancers') to allow developers and Kāinga Ora to sell homes to people who already own a home and have to relocate (e.g. downsize or move cities), so long as they meet the relevant income and residency requirements, and once the sale and purchase transactions are completed these people only own one home; | YES / NO | YES / NO |
|---|----------|----------|

Implementing a hierarchy of alternative purchasers (Cabinet decisions required)

- vii. **note** unsold KiwiBuild homes can only be sold to other purchasers without Cabinet approval or, at the end of a development if fewer than 15 percent of KiwiBuild homes remain unsold [CAB-19-MIN-0444];

Managing the increased costs and risks to the Crown of not being able to sell properties

- | | | |
|--|----------|----------|
| /iii. agree to seek Cabinet agreement to a hierarchy of alternative purchasers of KiwiBuild homes that would only apply once developers have made reasonable attempts to sell these homes to eligible purchasers (this would remove the current 15 per cent threshold for sales to other purchasers); | | |
| ix. agree that the alternative purchaser hierarchy comprise the following: | | |
| a. Progressive Home Ownership and Community Housing Providers or Kāinga Ora, ahead of other purchasers; and | YES / NO | YES / NO |
| b. any other purchasers except investors; and | YES / NO | YES / NO |
| c. investors; | YES / NO | YES / NO |
| x. agree those homes sold to other purchasers under options a. through c. above will not be counted as KiwiBuild homes; | YES / NO | YES / NO |

	s9(2)(f)(iv)		
xi.	s9(2)(f)(iv)	YES / NO	YES / NO
xii.	s9(2)(f)(iv)		
	s9(2)(f)(iv)		
κiii.	s9(2)(f)(iv)		
iv.	agree that HUD and Kāinga Ora work with the Ministry of Social Development to explore options to enable approved categories of Kāinga Ora tenants to access the Accommodation Supplement on the same terms as tenants of private landlords and Community Housing Providers;	YES / NO	YES / NO

Financial recommendations (Cabinet decisions required)

- xv. **note** that the KiwiBuild Programme was established in 2017 with a total funding envelope of \$2.1 billion comprising:
- a. \$100 million for Urban Development Authority establishment (including administration of KiwiBuild and Kāinga Ora's new statutory functions under the Urban Development Bill), of which \$50.004 remains unallocated; and
 - b. \$2 billion to facilitate the delivery of KiwiBuild homes (including via the Programme and Buying off the Plans delivery channels), of which \$950 million remains unallocated.

- vi. **note** officials are preparing fully costed proposals to access the unallocated funding in order to:
- a. ensure that HUD and Kāinga Ora are adequately resourced to meet next year's staffing and overhead costs;
 - b. support any advice to Cabinet, including where Ministers may wish to manage specific proposals in this paper within funding limits;
- vii. **note** that a number of the proposals in this paper will require Cabinet endorsement;



Brad Ward
Deputy Chief Executive, Placed-based Policy and Programmes

Ministry of Housing and Urban Development

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Caroline McDowall
Acting Deputy Chief Executive (Joint Urban Development – Delivery)

Kainga Ora – Homes and Communities

..... / /

Hon Dr Megan Woods
Minister of Housing

..... / /

Hon Grant Robertson
Minister of Finance

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Background

KiwiBuild Programme

16. KiwiBuild homes are currently delivered via three delivery channels:
 - a. the KiwiBuild Buying off the Plans initiative, which Kāinga Ora administers on behalf of the Crown using appropriated funding;
 - b. the Land for Housing Programme, which HUD administers on behalf of the Crown using appropriated funding;
 - c. through Kāinga Ora's own developments, including large-scale projects.
17. These delivery channels often work in tandem. For example, through the Buying off the Plans initiative underwriting the sale of KiwiBuild homes on land that developers and/or iwi have purchased from Kāinga Ora.

Recent advice on the potential impacts of Covid-19

18. On 24 April 2020 HUD submitted a briefing to the Minister of Housing outlining the potential impacts of Covid-19 for the residential construction sector [HUD BRF19/20040623]. The briefing was also forwarded to the Minister of Finance. The advice noted that the sector is particularly vulnerable to economic downturns and demand shocks. It has a history of pronounced boom-bust cycles where activity, capacity and skills exit quickly and return slowly. This means that even when the general economy recovers from a shock, housebuilding activity usually lags demand for many years.
19. This was most recently seen during the global financial crisis (GFC), when the supply of credit and effective demand for houses declined significantly, while the underlying demand continued to grow. As a result, between 2008 and 2011 housebuilding declined by approximately 50 per cent and the residential construction sector lost approximately 25 to 30 per cent of its workforce. Medium-to-high density developments were disproportionately affected, as they are harder to stage in order to manage development and sales costs and risks. These factors contributed to our current housing affordability crisis and to skills shortages.
20. While the drivers of the GFC were different to the current crisis, the resulting impact on the residential construction sector could be similar in effect. Faced with site closures, declining cash-flows and deteriorating development economics, and more risk aversion from the banks, several development and construction companies have already started reducing staff salaries and beginning layoffs. We have received reports of finance companies charging Covid-19 risk premiums.
21. From next week we will be undertaking a broader market intelligence gathering exercise to obtain on-the-ground real-time information about the impact of the Covid-19 and any resulting demand shock, including identifying any larger at-risk developments. This will

involve regular check-ins and establishing proactive information-sharing protocols with key stakeholders involved in or supporting residential construction. We will provide you with regular advice on the findings of this work. We will provide you with the next instalment of advice in two weeks. Our advice will include further analysis of the potential impact of Covid-19 on those households who might otherwise have been eligible purchasers of KiwiBuild homes. You may wish to wait for the first advice before making decisions on the options outlined in this briefing.

KiwiBuild can support some parts of the residential construction sector through Covid-19 and maintain delivery of affordable homes, but we believe we will need to make some trade-offs

22. The Kiwibuild Programme can help to address the issues outlined above for the developers that participate in the Programme. However, in the current environment this would require some reprioritisation of the programme's competing objectives:
 - a. supporting the construction of modest and inherently more affordable housing at pace and scale;
 - b. ensuring as many sales as possible are to eligible purchasers i.e. first home buyers and 'second chancers'; and
 - c. rapidly recycling the Government's Kiwibuild investment and returning it to the Crown by the end of the 10-year programme.
23. We anticipate that these objectives will be tested by a range of factors. For example:
 - a. there is increased likelihood of existing KiwiBuild underwrites being triggered, and homes that the Crown already owns becoming harder to sell, due to a possible reduction in the (already small) number of eligible purchasers who are willing and able to purchase KiwiBuild homes;
 - b. before commencing new developments or development stages, developers and their financiers will likely be seeking a greater proportion of outright purchase commitments or backstop underwrites from the Crown. We are already seeing this with existing KiwiBuild projects, as detailed in Annex B.
 - c. increased holding costs, including finance, rates, insurance, staff and other overheads, and reduced productivity due to supply chain disruptions, site shutdowns and social distancing requirements.
24. Collectively, these factors will mean the Crown may need to meet higher costs and risk in the short term, in anticipation that its investment can be recouped over time as market conditions improve. Given fewer people may be willing and able to purchase completed dwellings, we may also need to be more flexible about the tenure and who owns the homes.

25. We consider that this can be achieved in a manner that remains consistent with the overarching programme objective of delivering the right home, in the right place and at the right price. Our specific recommendations are outlined in the following section. The proposals can be selected individually, or together.

Proposed Amendments to KiwiBuild settings

26. The proposals are about both supporting the residential construction sector from the impact of Covid-19 and mitigating the risk of the Crown holding properties that it cannot sell.

Supporting the residential construction sector by sharing more costs and risks (no Cabinet decisions required)

27. Cabinet has previously indicated the Crown should moderate the amount of risk it accepts in a development, and provide a low value underwrite if at all possible. We propose that the focus should remain on the right home, at the right price point, in the right place. However, we consider that it would be beneficial for underwrite settings to be adjusted in anticipation of the much tougher market conditions, particularly for developers who require presales.
28. The Crown could take on a higher degree of risk by providing higher value underwrites with lower discounts, increasing the proportion of homes it underwrites within developments, and increasing the use of pre-purchase commitments (as opposed to requiring developers to try to sell the properties).

Supporting construction through upfront payments (Cabinet decisions required)

29. HUD's Land for Housing Programme is receiving requests to support developers with cashflow and feasibility on land that the Crown owns by assisting with payments for upfront project works, including planning, consenting, earthworks and other land investment. These costs can be capitalised by the Crown into land value and recouped when the land is sold.
30. This briefing seeks in principle approval from Ministers to this approach, with Cabinet agreement required to give it effect.

Managing the increased costs and risks of the Crown not being able to sell properties (Cabinet decisions required)

31. The amount of residual cost and risk that the Crown will carry depends on whether the homes it pre-purchases or underwrites can be sold. The Crown can mitigate this risk by:
- ensuring its assistance is provided to reputable developers, in high-growth regions, and suburbs where the median house price is higher than the price of a KiwiBuild home. This is already a focus for Kāinga Ora and HUD; and
 - adopting a more flexible approach to how KiwiBuild homes are used, and by whom. Proposed changes to current settings are outlined below.

Expanding the definition of an eligible purchaser (Cabinet decisions required)

32. We propose expanding the definition of an eligible purchaser (currently limited to first-home buyers and 'second chancers') to include existing home-owners who need to relocate (e.g. downsize or move cities) in order assist people that have been impacted by the Covid-19 pandemic. The criteria will be that they need to meet the relevant income and residency requirements for KiwiBuild and that they can only own one home once their sale and purchase transactions are completed.
33. We expect this change to have a minor impact on the rate of sales of KiwiBuild homes. These homes are designed to be "entry level" and home-owners forced to sell are likely to have a range of alternatives.

Allowing unsold KiwiBuild homes to be sold to a hierarchy of alternative purchasers (Cabinet decisions and legislative change)

34. Currently unsold KiwiBuild homes can only be sold to other purchasers with Cabinet approval or, at the end of a development if fewer than 15 percent of KiwiBuild homes remain unsold.
35. To support faster recycling of capital, and to avoid the risk of houses remaining empty (including the 88 houses that the Crown is already holding under the Buying off the Plans initiative), we propose that you seek Cabinet approval to a hierarchy of alternative purchasers under which Kāinga Ora and its development partners:
 - a. must make a reasonable⁵ attempt to sell KiwiBuild properties to eligible purchasers in the first instance;
 - b. may then offer any KiwiBuild homes not purchased by eligible purchasers to Progressive Home Ownership, Community Housing providers or Kāinga Ora for public or transitional housing;
 - c. may then sell any KiwiBuild homes not purchased by those entities listed in (b) to all other purchasers, except investors; and
 - d. may sell KiwiBuild homes to investors, once all other sales options have been exhausted.
36. If implemented in full, we anticipate that these proposals would have a positive impact on capital recycling and the rate of delivery of KiwiBuild homes. All these options require Cabinet agreement.

⁵ The minimum marketing period varies from development to development, but reasonable attempts covers the period up to the point where the developer may serve Kāinga Ora a notice of an intention to exercise the underwrite.

s9(2)(f)(iv)

37. s9(2)(f)(iv)

38. If you agree to this proposal, we also propose that HUD works with MSD to ensure that low to moderate income tenants can access the accommodation supplement where appropriate.

Legislative implications

39. s9(2)(f)(iv)

40. Kāinga Ora wishes to consider more generally its ability to rent to tenants who receive the accommodation supplement s9(2)(f)(iv). This is a more significant policy proposal, including for the Minister of Social Development and Cabinet.

41. We propose working with MSD on options to improve affordability for low-to-moderate income tenants by removing the current prohibition on these tenants accessing the Accommodation Supplement. This could be achieved in a manner that still provides an opportunity for Ministers to consider and manage the corresponding financial implications. For example, by making the extended eligibility subject to the issuance of a Gazette notice or including sunset provisions. Any changes will be subject to identifying a suitable legislative vehicle.

Financial implications

42. The KiwiBuild Programme was established in 2017 with a total funding envelope of \$2.1 billion comprising:

- a. \$100 million for Urban Development Authority establishment (including administration of KiwiBuild and Kāinga Ora's new statutory functions under the Urban Development Bill). \$50.004 million remains unallocated; and
- b. \$2 billion to facilitate the delivery of KiwiBuild homes (including via the Land for Housing and Buying off the Plans delivery channels) in the expectation that this funding would

be recycled and returned to the Crown within 10 years. \$400 million was subsequently redirected to progressive home ownership initiatives. \$950 million remains unallocated.

43. The proposals in this briefing would not require funding additional to these appropriations. We propose that officials prepare a proposal for your consideration that would allow some of the unallocated funding to provide HUD and Kāinga Ora with the capacity to meet staffing and overhead costs in 2020/21⁶, to implement the proposals outlined in this briefing.

Next steps

44. If you decide to recommend to Cabinet that it agrees to changes to KiwiBuild settings, we will prepare a draft Cabinet paper for your consideration.

Annexes

Annex A: KiwiBuild Buying Off the Plans Pipeline (market exposure)

Annex B: Kainga Ora market feedback on the impact of Covid-19 on KiwiBuild

⁶ Neither HUD nor Kāinga Ora have been allocated funding to administer KiwiBuild functions and delivery channels beyond June 2020

Annex A: KiwiBuild Underwrite Pipeline (market exposure)

s9(2)(f)(iv)							

s9(2)(b)(ii), s9(2)(ba)(i)

s9(2)(b)(ii), s9(2)(ba)(i)					

s9(2)(b)(ii), s9(2)(ba)(i)				