



Briefing

Updated costing of the proposed HomeStart changes

| | | | |
|------------------|--------------|------------------------|----------------|
| Date: | 25 June 2019 | Security level: | In Confidence |
| Priority: | High | Report number: | BRF18/19060323 |

Action sought

| | Action sought | Deadline |
|---|------------------------------|--------------|
| Hon Phil Twyford Minister of Housing and Urban Development | Agree to the recommendations | 28 June 2019 |
| Hon Nanaia Mahuta Associate Minister of Housing and Urban Development | For information only | N/A |
| Hon Jenny Salesa Associate Minister of Housing and Urban Development | For information only | N/A |

Contact for discussion

| Name | Position | Telephone | | 1 st contact |
|--------------|--|-------------|-----------|-------------------------|
| Fiona Ryan | Acting Manager, Housing System Performance | 04 901 9873 | s 9(2)(a) | ✓ |
| Matthew Galt | Senior Advisor, Housing System Performance | 04 896 5686 | | |

Other agencies consulted

Treasury, Housing New Zealand

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 MHUD:



Briefing

Updated costing of the proposed HomeStart changes

For: Minister Twyford, Minister of Housing and Urban Development

Date: 25 June 2019

Security level: In Confidence

Priority: High

Report number: BRF18/19060323

Purpose

This briefing provides updated costings for the proposed HomeStart changes that incorporate a more realistic growth projection, which is now based on estimates of dynamic growth including changes in home buyer behaviour.

Recommended actions

It is recommended that you:

HomeStart cost estimates

1. **Note** that the initial estimates of the cost of the HomeStart changes of \$111.6m only incorporated a simple contingency for growth in uptake over time. Upon further investigation the contingency seems too small.
2. **Note** that officials now estimate a revised costing of \$144.8m. This is \$33.2m higher than the initial costing because it incorporates a higher and more realistic projection of growth in uptake over time. Estimated growth is now based on historical growth and an assessment of the underlying drivers of growth.
3. **Agree** that the cost of the HomeStart changes reported in the Government Build Programme reset Cabinet paper be updated to reflect the revised costing (\$144.8m).

Noted

Noted

Agree/Disagree

Welcome Home Loan cost estimates

4. **Note** that the cost of the Welcome Home Loan changes is difficult to determine, but will likely be under \$3m. This cost is excluded from the \$144.8m for HomeStart and can be funded from the existing Welcome Home Loan appropriation. This is unchanged from earlier advice.

Noted

HomeStart deposit threshold

5. **Note** that up until the latest version the Government Build Programme Cabinet paper recommended eliminating the HomeStart deposit requirement for new builds. On balance, officials consider that it would be preferable to reduce it to 5% rather than zero. Reducing the HomeStart grant deposit requirement to 5% has a nearly identical effect as decreasing it to zero, but would provide clarity to buyers by aligning the requirements across the Welcome Home Loan and HomeStart schemes

Noted

and avoid the impression that the government is endorsing zero deposit mortgages.

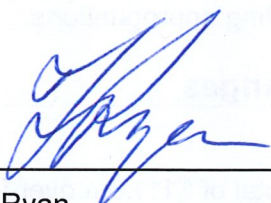
6. **Agree** that the HomeStart grant deposit requirement for new builds be reduced to 5% rather than zero.

Agree/Disagree

Cabinet paper

7. **Note** that the version of the Government Build Programme reset Cabinet paper currently out for agency consultation reflects the recommendations in this briefing.

Noted



Fiona Ryan
Acting Manager, Housing System
Performance

25.6.19.
..... / /

Hon Phil Twyford
Minister of Housing and Urban
Development

..... / /

Background

1. As part of the Government Build Programme reset, you have agreed to:
 - a. Double HomeStart grants for new build homes.
 - b. Reduce the deposit requirement on Welcome Home Loans to 5% and remove it for HomeStart, only for new builds.
 - c. Allow HomeStart grants to be paid to all eligible buyers where there are three or more buyers, for both new and existing homes.¹
2. The HomeStart changes will need to be paid for from new funding. This funding will need to come from a pre-commitment against Budget 2020, or be funded outside of the Fiscal Management Approach.
3. The Welcome Home Loan changes can be funded within the existing appropriations.

The cost of the HomeStart and Welcome Home Loan changes

Overview of the changes

4. Our initial estimate of the cost of the HomeStart changes was a total of \$111.6m over four years. The cost of HomeStart and Welcome Home Loans to the Crown depends on demand, so the costs of policy changes are sensitive to the assumptions used.
5. Our initial estimate of the cost was produced in a quick timeframe. The initial estimate of the cost included a static contingency for growth in uptake over time. Specifically, the majority of the costs arise from doubling HomeStart for new builds. We had initially estimated this as \$25m per year over the forecast period (totalling \$100m). This was based on the \$21.3m of grants for new builds being paid in 2018, but with a contingency added so that the cost would average \$25m per year over the four years to allow for growth. The flat time profile was a simplification and in reality it is more likely that payments for grants will grow over time.
6. Following fuller investigation and discussions with Treasury, we now consider our initial estimate of the cost to be too low. We now consider a more realistic estimate of the cost of the HomeStart changes is \$144.8m over four years. The revised estimate includes a dynamic estimate of growth based on growth in HomeStart uptake over the past few years and the underlying drivers of growth. This includes growth arising from KiwiSaver membership numbers, the increased availability of affordable homes through the Government Build Programme or the increased incentive to buy a new build given the larger grant.
7. Figure 1 provides a breakdown of our initial cost estimate and our revised cost estimate.

Figure 1: Initial and revised costings over four years (\$m)

| | Initial costing | Revised costing | Difference |
|--|-----------------|-----------------|-------------|
| Doubling HomeStart for new builds | 100 | 130.9 | +30.9 |
| Reducing the HomeStart deposit requirement | 8 | 9.6 | +1.6 |
| Making grants available to all buyers | 3.6 | 4.3 | +0.7 |
| Cost of HomeStart changes - funding to be sought | 111.6 | 144.8 | 33.2 |
| Reducing the Welcome Home Loan deposit requirement - to be funded from its appropriation | N/A | Up to \$3m | N/A |

¹ Other current eligibility criteria will apply, including the \$130,000 income cap in total across the buyers, the house price caps and the requirement to live in the home. This means that this provision will only be able to be used by groups of low income earners buying a modest home to live in.

8. Further sensitivity testing suggests that the cost of the changes could vary widely, over a range from \$90m to \$180m. However, after the policy decisions are agreed to by Cabinet, future changes in costs arising from changes in market conditions will be treated as forecast changes. This means that if actual costs diverge from the \$145m estimate, funding will automatically be provided from or returned to the centre.

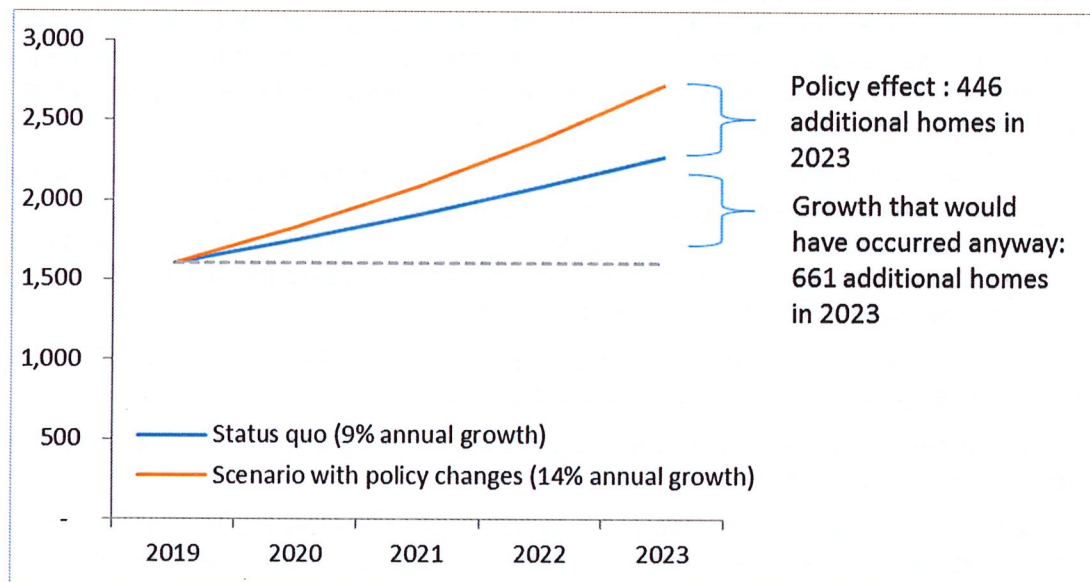
Further details

9. To develop more accurate estimates of the costs, officials created a model that calculates the cost of the changes based on spending in 2018 and a revised estimate of expected growth in uptake over time. The costs of the proposed changes are calculated from the difference in what the costs would have been absent the changes in policies (the status quo) with what the costs will be with the proposed policy changes (the scenario).
10. The key assumption is the growth rate in uptake, and how much faster uptake might increase if the changes are made. As a starting point, HomeStart grant uptake has grown by 7-10% per year over the past two years. Growth in uptake of new build grants was higher and more volatile than for existing homes (9% and 25% over the past two years for new builds respectively, compared to 7% and 6% for existing homes).
11. There are a range of reasons to expect that HomeStart grant uptake will continue to increase, with faster growth in uptake of new build grants:
 - a. The number of KiwiSaver members is generally growing and this will increase the pool of eligible people.²
 - b. It seems likely that the proportion of new builds priced below the HomeStart house price caps will rise as a result of the Government Build Programme and flattening house prices. This is an important change from the past as rising house prices have been the key driver holding down HomeStart spending in the past (and generating the underspend).
 - c. A larger new build grant will encourage people to switch to buying new builds rather than existing homes.
 - d. The government's broader housing programme might increase the overall number of first home buyers.
12. It is possible that uptake could decline, for example if there was an economic downturn. On balance though it seems likely that uptake will increase.
13. Determining the best growth rate assumption is a judgement call. However, our revised base case assumes:
 - a. Growth in new build grants of 9% under the status quo and 14% in the scenario where the policy changes have been made.
 - b. Growth in existing home grants drops from 6.5% under the status quo to 6.25% in the scenario where the policy changes have been made, as some buyers switch to buying new builds.
 - c. Total growth in HomeStart grants (both existing and new builds) is 7.1% under the status quo and 8.2% in the scenario where the policy changes have been made.
14. These assumptions are based on recent growth in uptake of HomeStart grants, our judgement that growth will continue, and sensitivity testing about how realistic the scale of uptake of HomeStart implied by these assumptions is.

² There was 6% annual growth in the number of KiwiSaver members aged 25-44 over the past two years, though this rate of growth is declining

15. These assumptions see the number of new builds purchased with the help of a grant rise from 1,607 in 2018 to 2,714 in 2023, or an additional 1,107 homes in 2023. Of this, 40% of the growth is assumed to be due to the policy changes and the remainder is assumed to have occurred anyway (ie the status quo). Figure 2 illustrates the concept and Annex One provides the full outputs of the model.

Figure 2: The assumed effect of the policy changes on the number of homes purchased with the help of a HomeStart grant due to the policy changes



16. One sense check of this is the share of new builds bought with the help of a HomeStart grant. Currently around 5% of new builds are bought with the help of a HomeStart grant nationwide. The share varies around the country, and an example of where it is very high is greater Christchurch, where 12% of new builds are bought with the help of a HomeStart grant. In our base scenario, the share of new builds bought with the help of a HomeStart grant rises from the current 5% up to 7.6% by 2023 assuming around 35,000 homes are built per year.
17. The growth rate in grants for new builds has to be 6.5% or lower to get a costing as low as the earlier \$100m estimate for doubling HomeStart. Officials consider this to be unrealistic as a central scenario. It is well below recent growth rates, and would largely only allow for growth in KiwiSaver membership numbers. It would not allow for growth arising from other drivers, such as the increased availability of affordable homes through the Government Build Programme or the increased incentive to buy a new build with the larger grant. A cost of \$100m might represent a low side scenario, such as where the economy weakens and fewer households are able to purchase a first home.
18. A high scenario could involve around 20% annual growth in HomeStart grants for new builds – near to what has been seen over the past year. Officials consider that a rate of growth this high is unlikely to be sustained. However, if growth this high occurred, the cost over four years would be \$182m. The share of new builds purchased with the help of a HomeStart grant would nearly double from 5% to over 9%.
19. The time profile of the revised cost estimate is given in Figure 3.

Figure 3: Revised costs of the HomeStart changes

| Year | Initial costing | Revised costing | | | |
|--------------|-----------------|-----------------|--------------------|------------------------|---------------------------------------|
| | Total | Total | Doubling HomeStart | Reducing deposit to 5% | Opening up to groups of three or more |
| 2020 | 27.9 | 28.1 | 25.2 | 1.9 | 0.9 |
| 2021 | 27.9 | 32.9 | 29.7 | 2.2 | 1.0 |
| 2022 | 27.9 | 38.6 | 35.0 | 2.5 | 1.1 |
| 2023 | 27.9 | 45.2 | 41.1 | 2.9 | 1.2 |
| Total | 111.6 | 144.8 | 130.9 | 9.6 | 4.3 |

20. The cost of reducing the HomeStart deposit to 5% (or zero) is estimated as being 4% of the total amount paid for new build grants. This assumption is unchanged from the initial costings, but the higher growth projection means that the cost has increased slightly. This is based on Reserve Bank statistics suggesting that around 4% of first home buyers use loans with Loan to Value ratios (LVRs) of between 90 and 95, and almost none with LVRs over 95.
21. The cost of opening up HomeStart grants to all buyers in groups of three or more buyers is estimated as 0.8% of the cost of all grants, and this assumption is also unchanged from the initial costings. This is based on 0.65% of grants last year being paid to groups of buyers, plus a small amount to take into account behaviour change that that may result from the policy change.

Costs of the Welcome Home Loan changes

22. We have also more fully evaluated the cost of the Welcome Home Loan changes, and the results of this analysis are in line with earlier advice. We estimate that reducing the Welcome Home Loan deposit from 10% to 5% will cost between an additional \$1-3m over four years, which will be funded from its own appropriation underspend.³ This cost is not included in the \$144.8m for the HomeStart changes as it will be funded from within the Welcome Home Loan appropriation. The appropriation is currently underspent by around \$2m per year, so a total amount of \$1m-\$3m over four years should fit within the existing appropriation.

Alignment of the 5% deposits for new builds between HomeStart and Welcome Home Loans

23. Our earlier advice was to reduce the deposit requirement for both Welcome Home Loans to 5% and the HomeStart deposit to zero. The zero deposit for HomeStart would have a nearly identical effect as a 5% deposit requirement. This is because most HomeStart users would have near to a 5% deposit between the grant and their KiwiSaver funds, and banks currently almost always require a 5% deposit.
24. Making the deposit requirement zero would save buyers and Housing New Zealand the minor administrative cost of demonstrating they have a 5% deposit when accessing the HomeStart grant but not the Welcome Home Loan. This administrative cost would be minor given that in most cases HNZ will be able to confirm an adequate deposit from KiwiSaver and the grant alone (the grant counts towards the deposit requirement).

³ The estimate is based on a total of an additional \$100m-\$250m of Welcome Home Loans being drawn for new builds over a four year period, and the underwrite cost of a Welcome Home Loan being 1.2% of the loan value. A total of \$476m of Welcome Home Loans were drawn in 2018, of which \$30m was for new builds.

25. Given the administrative cost is minor, on balance we consider that it is worth aligning the deposits for new builds at 5% for clarity of communication. This will ensure that buyers understand that they require a 5% deposit for new builds and 10% for existing homes to access HomeStart and Welcome Home Loans. Having different deposit amounts could result in confusion, such as the mistaken impression that the government is endorsing zero deposit mortgages (which are risky and very rarely provided by banks).

Next steps

26. The version of the Government Build Programme reset Cabinet paper currently out for agency consultation already reflects the recommendations in this briefing. If you agree to the recommendations in this briefing we will continue to reflect them in the Cabinet paper. If you disagree we will change the Cabinet paper accordingly.



Annex One: The model and its outputs

| ASSUMPTIONS | | Scenario where policy changes are made | |
|---|--------|---|----------|
| New build growth per year | | 9.00% | 14.00% |
| Existing home growth per year | | 6.50% | 6.25% |
| Total growth (2019 split of new/existing) | | 7.12% | 8.17% |
| New build grant amount (\$m) | | 0.008833 | 0.027666 |
| Existing home grant amount (\$m) | | 0.004462 | 0.004462 |
| Increase in new build grant amount | | 100% | |
| Increase in existing home amount | | 0% | |
| Grants per existing home | | 1.40 | |
| Grants per new build | | 1.50 | |
| MODELLED OUTPUTS | | | |
| STATUS QUO | | SCENARIO WHERE THE POLICY CHANGES ARE MADE | |
| NUMBER OF GRANTS | | DIFFERENCE BETWEEN SCENARIO AND STATUS QUO | |
| Year ended June | | Year ended June | Total |
| 2019 | 14,500 | 2019 | 16,910 |
| 2020 | 15,443 | 2020 | 18,069 |
| 2021 | 16,446 | 2021 | 19,310 |
| 2022 | 17,515 | 2022 | 20,636 |
| 2023 | 18,654 | 2023 | 22,056 |
| NUMBER OF HOMES | | Share of consents bought with help (assumes 2% annual of HS grant) | |
| Year ended June | | Year ended June | Total |
| 2019 | 10,357 | 2019 | 11,964 |
| 2020 | 11,030 | 2020 | 12,782 |
| 2021 | 11,747 | 2021 | 13,656 |
| 2022 | 12,511 | 2022 | 14,592 |
| 2023 | 13,324 | 2023 | 15,592 |
| COST (\$m) | | Reducing deposit to 5% for up to new groups of three or more new build grants | |
| Year ended June | | Year ended June | Total |
| 2019 | 21.3 | 2019 | 21.3 |
| 2020 | 23.2 | 2020 | 25.3 |
| 2021 | 25.3 | 2021 | 30.0 |
| 2022 | 27.6 | 2022 | 35.5 |
| 2023 | 30.0 | 2023 | 41.9 |
| Total | 106.1 | Total | 132.7 |