

Treasury Report: Briefing to incoming Minister of Housing

Date:	11 July 2019	Report No:	T2019/2040
		File Number:	SH-18-2

Action Sought

	Action Sought	Deadline
Minister of Finance (Hon Grant Robertson)	Note this briefing provides a high-level overview of the housing portfolio	none
Minister of Housing (Hon Dr Megan Woods)	Agree to meet with Treasury officials to discuss housing	none

Contact for Telephone Discussion (if required)

Name	Position	Telephone		1st Contact
Bastiaan van der Scheer	Principal Analyst, Housing & Urban Growth	s9(2)(k)	s9(2)(a)	✓
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Actions for the Minister's Office Staff (if required)

Return the signed report to Treasury.

Note any feedback on the quality of the report

Enclosure: No

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Executive Summary

This briefing responds to a request from the Minister of Housing for our view of the key issues in the housing portfolio.

We understand your goal is to take action to meet the large and growing need for warm, healthy and affordable homes. Delivering on this will require successful implementation of:

- A homelessness response, including public housing;
- Government-supported affordable housing; and
- Affordable housing by the private sector.

Successfully delivering these three work areas will require changes to the weighting of goals and/or incentives on government departments, councils, landowners, and developers. While everyone can agree they want affordable housing, a credible path to delivering it is yet to be established in the face of current constraints.

There are a number of risks in the portfolio for you to be aware of and manage:

- Treasury and other commentators/economic forecasters expect house and rent prices to continue to increase over time, creating increased hardship, homelessness, public housing demand and fiscal costs;
- Government build programmes (KiwiBuild and Public Housing) have not met new build targets in the past, s9(2)(g)(i)
s9(2)(g)(i)
- s9(2)(f)(iv)

You can shape existing work programmes to deliver your goals and manage the risks. We suggest this includes:

- Setting focussed goals, strategy and funding for Kāinga Ora to deliver public and affordable housing;
- Changing requirements and/or incentives for local government to take a permissive approach to housing zoning, including using Kāinga Ora in the short term; and
- Providing directives and new tools to plan, fund and finance the infrastructure needed for housing to go up and out.

Recommended Action

We recommend that you:

- a **note** there is a wide set of goals influencing projects in the housing portfolio
- b **note** high housing costs and poor housing quality are affecting a large portion of the population, creating a wide range of potential target groups for government assistance
- c **note** housing costs and quality have wide ranging impacts on wellbeing and providing support to those without stable, warm and healthy housing will improve wellbeing.
- d **note** we diagnose the high cost of housing as primarily due to land use restrictions and bulk infrastructure planning, this restricts the range of effective policy tools at your disposal to make a positive impact for a large number of New Zealanders currently facing hardship due to housing costs
- e **note** we see a benefit in narrowing the initial focus of housing agencies to:
 - Using government assistance to target those most in need;
 - Using government projects to increase the volume of houses being made, and way in which they are delivered; and
 - Housing affordability through actions that lead to the removal of costly restrictions on housing supply
- f **note** we suggest the use of the following key levers to drive the housing portfolio:
 - Working across Cabinet to implement changes to the way land and infrastructure is regulated and provided to enable affordable housing;
 - The legislation currently underway to orient and empower Kāinga Ora;
 - Using the Funding and Financing work programme to select and focus Government projects on achieving your priority goals; and
 - Using the Public Housing Funding Review to maximise the impact of public expenditure on housing
- g **note** we are able to provide more detailed advice as requested
- h **agree** to meet Treasury officials to discuss housing.

Agree / Disagree

Melody Guy
Manager, Housing & Urban Growth

Hon Grant Robertson
Minister of Finance

Hon Dr Megan Woods
Minister of Housing

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Purpose of Report

1. This briefing provides the requested high-level view of the housing portfolio. We can provide further information on the topics covered at your request.
2. The briefing covers: key issues within the housing portfolio, the causes of unaffordable housing, suggestions for where you can focus, and your levers to set policy.

Analysis

3. The high cost of housing is unaffordable for many, and New Zealand has the highest housing costs compared to income in the OECD. This means warm and healthy housing is out of reach for a large and growing number of people.
4. Median homes in our cities such as Auckland, Tauranga, and Wellington are out of reach for middle and lower income households, and the affordability gap is large (generally over \$100,000). Rental payments are also unaffordable for many with the national average asking price on Trade Me now \$500 a week.
5. High housing costs have negative impacts on living standards and intergenerational wellbeing. High costs diminish human, social and physical capital. High rents restrict access to cities and the opportunities within them. Households have to make stressful trade-offs in household spending, often cutting back on other areas of spending and accepting poor quality housing to stay within budgets.
6. The increasing costs of shelter disadvantage the young and those with lower incomes, who are less likely to own a home.

Affordable housing is possible with policy change

7. Housing is highly regulated and constrained; the resulting shortage followed by high prices is a result of the accidental cumulative impact of many policy choices.
8. Housing does not need to be unaffordable in growing and prosperous cities. A third of cities in the US are growing, prosperous and affordable, examples include Orlando, Atlanta, Columbus, Colorado, Minneapolis and Houston. There will still be a need for housing supports within a responsive housing market, but the cost is lower and ability of government to meet that need is reduced.
9. The lesson from these successful and affordable cities is that the institutional roles and incentives in New Zealand need rebalancing to allow those that benefit from growth to come together to plan and fund the land and infrastructure required. Achieving this will require coordinated actions across Cabinet.

Land use policy drives high costs

10. Housing is expensive because councils heavily restrict land for housing in their district plans and do not plan sufficient growth bulk infrastructure. There are many reasons for this. The resulting dynamics in the land and build market exacerbate the initial shortage.

11. In most New Zealand cities, the supply of greenfield land is deliberately limited, and the most in demand brownfield land has strong height, density and other limits. The rules that determine what can be built where are hampering the flexibility of housing supply to respond to demand pressures from population growth.
12. These regulations are adding a differential between the cost of producing a house when the system is responsive, and the price of existing houses in Auckland. The regulatory burden in Auckland has been assessed at around \$530,000.¹ Supply is so restricted, that at the urban boundaries of most our major urban centres, a simple change in zoning to allow housing would add over \$100,000 to the value of a section.
13. High land values in the highest demand locations are not problematic for wellbeing if developers can respond by increasing the utilisation of expensive land through intensification, and urban expansion provides alternative options. In an environment where it is possible to go up and out, the abundance of opportunities can keep the cost of housing affordable for most people.

Government support cannot meet demand unless the system changes

14. This shortage and resulting high cost forces households to spend more of their income on housing, to the detriment of all other spending. Government investment in housing support is high and unable to meet the level of demand that results. The Government now spends more than \$3 billion per annum on housing assistance. Without supply reforms, building programmes will be expensive, inflationary, and slow to deliver.
15. Even with substantial increases in budgets, housing assistance cannot address housing need across the spectrum in the current housing environment.

s9(2)(f)(iv)

The Homelessness Response has organisational, resourcing and regulatory issues to overcome

16. Building quickly in response to homelessness is constrained by the need to find and consent land and link to bulk infrastructure. The Ministry of Housing and Urban Development (MHUD) is preparing a plan to address homelessness. A key decision is the amount of reliance to place on securing existing housing through buy-ins and leases in both the short and long term. A drawback is that government response displaces other households, but it would allow a quick response short of organisational and regulatory action to speed building.

The key players in the system

17. The Ministry for the Environment (MFE) advises on and administers the regulatory system governing land use (Resource Management Act 1991). The Environment Act 1986 tasks the MFE with having regard to a number of matters that need to be balanced with policy for housing affordability.
18. Councils regulate land use allocation by setting rules, and both plan and finance trunk infrastructure. Regional councils set resource management policies, objectives and methods. Councils have to balance the political considerations of existing communities and balance growth infrastructure spending with other goals. The result is many do not allow urban expansion and struggle to enable intensification.
19. Landowners generally look to maximise their returns. A shortage of land with zoning for housing and sufficient infrastructure limits the number of landowners who can use their land for housing. The scarcity of serviced land in most urban areas increases its value.

¹ Lees, K. (2017) Quantifying the impact of land use regulation: Evidence from New Zealand. Sense Partners. Report for Superu, Ministerial Social Sector Research Fund. June 2017.
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When the value of buildable land inflates faster than holding costs, land-banking makes economic sense and often results. Making large amounts of new land available will encourage the development of existing land as it will no longer be profitable to hold it.

20. Developers look to create value by converting land to housing and intensifying existing urban land. They are reliant on a supply of land for housing, and having access to bulk infrastructure. The supply of land needs to be at a price that allows the houses built to be sold at a cost people are willing to pay. A reliable pipeline of greenfield land would allow large scale building and efficient construction techniques. This will also have a positive impact on the structure and sustainability of the sector (less 'boom and bust').
21. MHUD develops the policy for and funds housing assistance as well as seeking to create thriving communities. MHUD seeks to balance multiple goals in respect of the urban environment.
22. Housing New Zealand (HNZ), soon to be the Crown Entity Kāinga Ora, delivers a large part of the Government building programme and runs public housing. It has over ten functions in the legislation going through Parliament. The competing demands for resource (including what to spend public housing rents on) are often internalised and limit your ability to direct public resources to your highest priorities.
23. The key to unlocking this system is focusing regulatory action from officials on the goal of housing affordability, and developing options to incentivise council behaviour; thereby releasing land that both increases the number of landowners that are able to supply housing and pushes landowners to act now rather than delay. The development and construction sectors will have an opportunity to grow that is currently hindered by fragmentation and 'boom and bust' housing cycles.

Suggestions for your focus in the housing portfolio

24. We suggest focusing on short term actions that move towards affordable housing for everyone while also increasing public housing to meet acute demand. We suggest three focus areas.

Focus One: government resources on supporting the homeless and those in high need through public housing

25. The public housing waiting list is growing fast (now 11,655 plus 2,535 waiting for a transfer) and the lack of places combined with low turnover (8% of tenancies, about 5,000 a year) is forcing the use of poor substitutes. 1,899 households are in private motels, with 381 households in motels for over three months at a cost of \$1,500 per week. 2,782 households are in transitional housing, which is often government-contracted motels, at a cost of \$1,349 per week (including services).
26. Kāinga Ora is a Crown Entity in the process of formation to perform over ten functions (current bill draft). The risks for you having a delivery agency with such a wide range of functions is that:
 - Resources are not utilised in line with your goals;
 - Trade-offs are not transparent; and
 - Organisational focus is not on delivering the outcomes you care most about.

27. You have three key levers to influence Kāinga Ora.

Lever 1: Setting priorities for Kāinga Ora through the Government Policy Statement (GPS)

28. You will have to issue a Government policy statement on housing and urban development within one year of the enactment of Kāinga Ora's enabling legislation. This is your opportunity to state your priorities, which Kāinga Ora must give effect to when performing its functions.

29. We recommend you limit your goals with an emphasis on managing and delivering additional public housing, and enabling housing supply. Without this narrow focus, it is likely that alternate goals dominate decisions on housing project selection, scope and funding. You can introduce other priorities after the acute need for housing is met.

Lever 2: Use the Public Housing Funding Review to understand costs and pay for what you want

30. Many decisions are internalised by HNZ as the provider of around 93% of public housing. HNZ "funds" the delivery of these services through accepting low returns on capital (typically cash returns are below 2%). It can do this due to the balance sheet strength it has accumulated through capital gains over time and potentially reducing its land holdings ^{s9(2)(g)(i)}. This is not sustainable in the longer run as borrowing levels and costs increase.

31. The payments historically made to HNZ have allowed it to either expand or renew its stock. The cumulative impact of the underfunding and lumpy nature of its historic build programmes is a housing portfolio that is now badly in need of renewal.

32. To set public housing on a footing where it can respond to increases in demand you can develop a funding model for public housing that is sustainable and provides incentives for value for money in investment decisions on supply, maintenance, refurbishment, redevelopment, design and geographic location of public housing.

33. The way to deliver the above would include offering attractive payments that cover the costs of providing public housing. Market rents fall short of allowing investment in new public houses. The funding review could help build a case for increased government investment in public housing. It can also highlight the potential value of schemes that can support public tenants and applicants to successfully enter and sustain private tenancies; thereby reducing demand for more public housing places.

Lever 3: Use the borrowing limit and Budget bids to require transparency from the build programme

34. Kāinga Ora is seeking to finance its programme through private borrowing. The Minister of Housing and the Minister of Finance agree limits on this borrowing. MHUD are currently confirming funding, investments and upcoming decisions as part of the Funding and Financing work programme. This work programme is an opportunity to understand the pipeline of projects, their current resourcing and to shape the pipeline to deliver on your goals.

35. s9(2)(f)(iv)

- Any use of KiwiBuild capital that does not recycle the funds: there is around \$2.1 billion of KiwiBuild funding;
- New large-scale projects: each of the large scale projects (e.g. Unitec, Manukau, and Porirua) s9(2)(j)
s9(2)(j)
- Increases to public housing: s9(2)(f)(iv)
-

Focus Two: Kāinga Ora urban development on housing affordability

Overcome the barriers to affordable housing through Kāinga Ora

36. Government project selection is not driven by impact on affordability; it is driven by existing land holdings and legacy projects selected for goals other than housing affordability. You can change this through a combination of communicating your expectations, and your control of funding via the Budget process and debt limits.
37. An approach focused on lowering the price of housing would work to overcome housing restrictions that the private sector currently cannot. To do this Kāinga Ora (and ideally a wider set of providers) will need powers to zone land and supply infrastructure. This approach will require a more enabling and faster process for releasing land to be established for Kāinga Ora as part of the 'cut through powers' planned for a second establishment bill.
38. An example of this approach in action would be s9(2)(b)(ii)
s9(2)(b)(ii) affordable housing focussed projects that bring forward land Auckland Council does not plan to release for 20 years and 'leapfrogging' to enable rural zoned land in the short term. The limited and staged nature of current plans lead to council modelling suggesting average sales prices of \$1.5 million per feasible greenfield dwelling – and will not deliver affordable housing.

What does an affordability focused approach for Kāinga Ora look like?

39. Inner suburbs: Purchase high value land, which will generally be close to the CBD (with existing uses), deploy Crown zoning, consenting, development planning, capital, financing and risk appetite to support medium - high density apartments where this kind of development is currently prohibited or difficult. The existing buying off the plans programme is also likely to be a good platform for supporting higher density developments.
40. Infill sites over 10km out from the CBD: Due to legacy land holdings, the wider Crown (including local government) is likely to have significant access to urban brownfield sites. Land can be acquired and quickly sold with minimal conditions (pace, price and scale) to private developers. This is similar to the current land for housing programme.

41. Greenfield: Acquire rural land priced at rural levels or just above (from willing sellers), change zoning, introduce infrastructure funding and financing mechanisms (potentially including targeted rates), sell with binding conditions on pace and scale.

Focus Three: short-term regulatory effort on enabling housing to reduce growing unmet demand.

42. A generally permissive approach of enabling housing both up and out is required or prices (public and private) will continue to increase. This will require changing council's choices (through persuasion and incentives), requiring actions from them they do not wish to pursue (through an enforced, proscriptive and directive National Policy Statement) or bypassing them (through devolution and/or centralisation of functions).
43. Many councils and government agencies will be resistant to opening up the restrictions on housing supply through a generally permissive approach that includes urban expansion, as they value competing goals that they see to be in conflict. A strategy to manage this could include combining a strong case for change with mitigations for concerns such as infrastructure standards and protections for special areas from development.
44. Relying in a large extent on demand side assistance such as rental assistance and home ownership assistance will struggle to increase supply given the constrained environment. In fact, financial support is likely to increase prices when supply is constrained. The Accommodation Supplement and HomeStart grants are examples of demand side assistance.

Influence the Urban Growth Agenda (UGA) including upcoming Cabinet decisions

45. Two Cabinet papers due in July/August will have material impacts on housing supply:
- The National Policy Statement on Productive Soils seeks to increase the weight given to protecting productive soils from housing expansion. Treasury has included a split recommendation due to concerns about the negative impact on future housing supply and need for a better cost benefit analysis before public consultation; and
 - The National Policy Statement on Urban Development seeks to require councils to provide adequate development capacity through enabling intensification and expansion. This approach is likely to help; there is an option to push this to go further. We can provide options at your request.
46. Enabling an increased supply of public and private houses to meet demand will require ongoing reform to improve the quantum of development opportunities and require bulk infrastructure provision plans for housing. The relevant portfolios to allow this to happen span across Cabinet.

Annex: Housing Appropriations

Main Appropriations

The largest housing appropriations are listed below:

- Accommodation Assistance (\$1.180 billion): this is difficult to re-prioritise because it is a forecasted benefit. As long as an individual meets the requirements for receiving a payment under this appropriation a payment is made.
- Public Housing Multi-Category Appropriation (\$1.151 billion): the largest spend in this appropriation is for Income-Related Rent Subsidy places paid to HNZ and Community Housing Providers. This appropriation also funds a part of the Housing First programme.
- Transitional Housing Multi-Category Appropriation (\$138.862 million): this funds transitional housing places and support services, and includes capital to bring on permanent supply. This funding is available to be prioritised, but would be at the cost of homelessness intervention.
- Housing Infrastructure Fund Loans (\$642.824 million) this appropriation is for providing loans to territorial authorities. This funding is contractually guaranteed and cannot be reprioritised.
- HNZ Debt Refinancing (\$251.246 million): this appropriation allows HNZ to refinance Crown loans. This funding is a forecasted appropriation and cannot be reprioritised. This appropriation sits in Vote Finance.

KiwiBuild

There is around \$2.1 billion of KiwiBuild funding. This funding is currently in the KiwiBuild housing operating appropriation, as this funding is used to purchase KiwiBuild dwellings, which are then on-sold (i.e. held as inventory).

KiwiBuild funding has been provided on the basis that the revenue generated by the sale of proceeds is to be “recycled” back into the KiwiBuild programme over ten years. This means that this funding is considered fiscally neutral on the basis that it has been forecasted as coming back to the Crown. [REDACTED]

s9(2)(f)(iv) [REDACTED]

Contingencies

There are a number of housing contingencies, which you can access with Joint Ministerial agreement in the next 12 months:

- s9(2)(f)(iv) [REDACTED]
- [REDACTED]
- Transitional Housing capital contingency: \$113.430 million

All contingencies have drawdown conditions as stipulated in the Budget package.