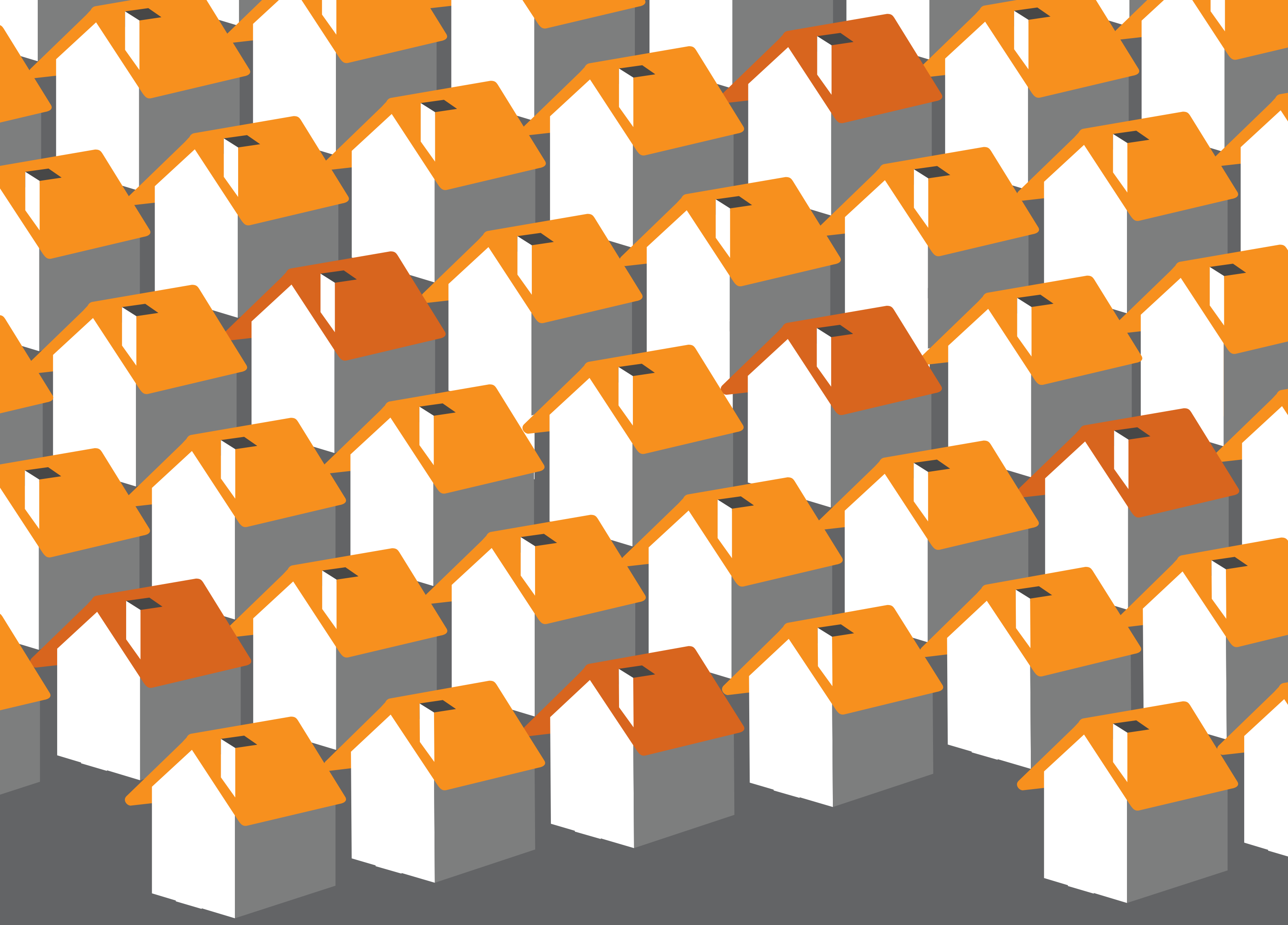

The next step in addressing housing affordability

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On 24 July 2020, the Minister of Housing Dr. Megan Woods announced a new $400 million investment package to promote Progressive Home Ownership. This fund will be administered by the Ministry of Housing and Urban Development (MHUD) and its delivery agency Kāinga Ora. Unlike previous affordable housing schemes, such as KiwiBuild, which primarily target first home buyers, this new scheme is likely to focus on a wider range of potential beneficiaries – for example, families seeking fit for purpose housing.

The new Progressive Home Ownership scheme partners with, and provides funding mechanisms to, both new and existing affordable housing providers, instead of the Government facilitating the direct delivery of affordable housing.

Affordable housing remains a critical challenge for New Zealand in social and economic terms. It is a complex and multifaceted problem, reflecting a number of underlying supply and demand issues. In New Zealand, the market generally favours supplying housing typologies and housing sizes targeted at the typically more profitable and less risky sub-markets which are out of reach of most low income households. Progressive Home Ownership models could be an important part of a multi-pronged approach to diversify housing options and, in particular, promote delivery of homes that can genuinely be acquired by lower income households.

Implementation of a Progressive Home Ownership policy without a concurrent supply response could have unexpected outcomes – creating more demand for homes that do not exist. Kāinga Ora has policy in place to promote supply. This will be an important element in advancing overall housing affordability.

Over the past six to eight years, more dense typologies such as terrace housing have become commonplace across New Zealand. Suburban apartments are growing in popularity in our main cities. We have seen a steady decline in the average size of new homes. Collectively, these factors are favourable signs for housing affordability.

The original KiwiBuild policy had a part to play in the trend towards more densely built and smaller homes. It was a catalyst for these two trends and one of its key functions was to mitigate the risk of developing what were (then, albeit less so now) less market attractive typologies.

Iwi will likely play a significant partnering role in the delivery of affordable housing. A key function of Kāinga Ora's role in Progressive Home Ownership is to understand, support and enable iwi aspirations.

A critical issue facing government intervention in the affordable housing market is the unsustainable, unscalable and potentially inequitable value transfers which can take place – from the taxpayer to the homeowner beneficiary. Over the past ten years, we estimate that the Government has either directly subsidised the cost of, or forgone revenue from the sale of, affordable housing, sometimes at a cost of up to or over $100,000 per affordable dwelling delivered. The result has been a direct value transfer from the public purse to some homeowners.

Over the past ten years, both central and local government have implemented a number of measures to tackle housing unaffordability. These have mostly focused on supply-side activity, including policies to promote intensification and to mandate affordable housing development, such as:

a) Special Housing Areas (SHA) to streamline delivery of housing development, most of which have affordable housing allocations.

b) Significant up-zoning in Auckland via the Auckland Unitary Plan, to create/stimulate additional supply.

c) The Urban Development Act, which sets the framework for Kāinga Ora to establish Urban Development Authorities for candidate scale urban regeneration and renewal projects.

d) The National Policy Statement on Urban Development, which includes eleven policies to improve housing supply.

e) Establishment of the Resource Management Reform Panel which aims to improve environmental outcomes and enable better and timely urban development within environmental limits.

f) Subsidising and underwriting new housing developments, with the objective of increasing housing supply and repositioning the market around more affordable price points, for example Hobsonville Point, Waimahia and the KiwiBuild program. The KiwiBuild program has enjoyed some success, particularly in terms of focusing the private sector on delivering smaller dwellings at lower price points, but the program has also faced some of the challenges outlined at the beginning of this document.

g) Finding new ways to fund and deliver essential infrastructure like Kāinga Ora's establishment of the Piritahi Alliance, and the creation of the Infrastructure Funding and Finance Act (IFF) which opens up new ways for local government to fund and finance infrastructure to unlock housing supply.

h) Advancing policy to provide a more attractive housing rental environment for tenants.

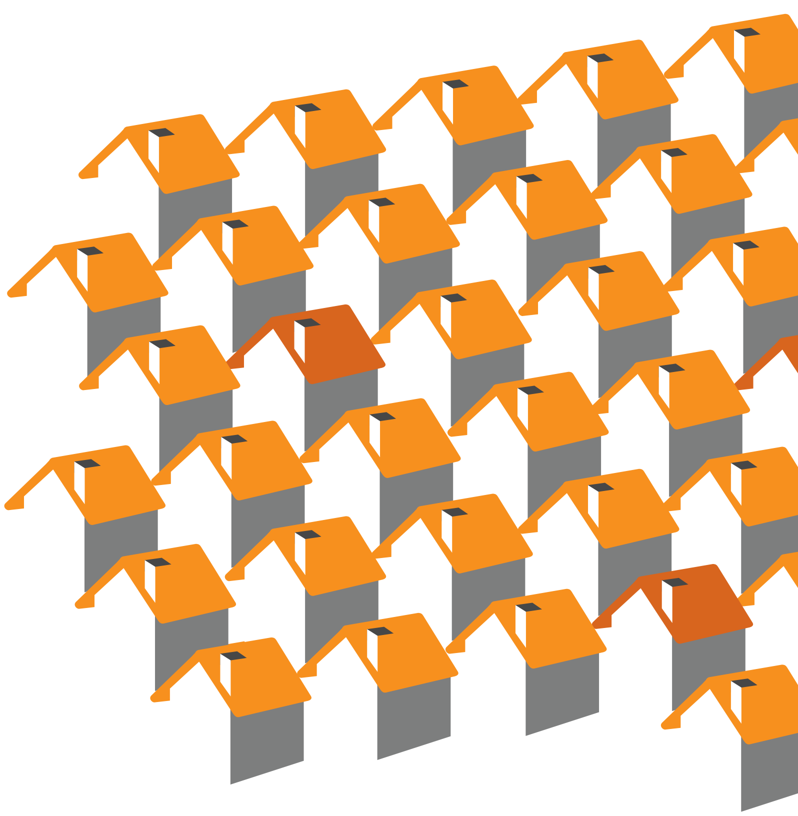
> "The Government is now planning to ramp up its demand-side activity through the recent focus on Progressive Home Ownership.

Some of these measures have been more successful than others. Some are yet to be fully implemented and tested.

A key focus of central government's affordable housing strategy to date has been based on stimulating supply. In essence, the Government has sought to reduce barriers for developers, such as assisting with mitigating sales and financing risk in exchange for developers advancing project (supply), ideally producing smaller and more intensive dwellings and delivering housing at lower margins to support more affordable housing.

On the demand side, the Government's focus has been via the First Home Grant, First Home Loan and facilitating the KiwiSaver withdrawal mechanism. It has also relied on other entities to assist first home buyers e.g. the New Zealand Housing Foundation.

The Government is now planning to ramp up its demand-side activity through the recent focus on Progressive Home Ownership.



Options for Progressive Home Ownership

There are a variety of local and international housing affordability models to draw from to facilitate affordable home ownership.

It is critical, from both a 'value for money' perspective and in terms of making material inroads to addressing affordability, that whatever model or models the Government pursues, they are:

Scalable, in terms of providing the ability to access or utilise both private sector and not-for-profit balance sheets and resources and not just rely on the public sector's purse.

Sustainable, by limiting the amount of subsidy or value transfer to homeowners which cannot then be recycled or regenerated into the future.

Structured to deliver housing at the lowest cost, so as to prevent value leakage. Anecdotally, the Crown spends considerably more than what the private sector typically spend to procure the equivalent product or service, including housing. Well-aligned partnerships with the private and not-for-profit sectors will be critical to achieving this goal.

Equitable, so as not to unduly benefit or enrich an individual homeowner at the expense of equally needy peers or the taxpayer.

Meaningful, in terms of targeting a deeper and wider demographic of need, so as to maximise the public good which arises from the activity.

Any intervention to support affordable housing needs to be targeted to assist first home buyers who need the greatest support. This cohort is typically those who neither qualify for scarce social housing, nor meet market or current affordable housing criteria.

As these proposed mechanisms primarily target the demand side of the equation, some care must be taken to avoid overstimulation of the housing market. This would result in the unintended consequence of demand exceeding supply and housing becoming increasingly unaffordable.

A key requisite of successful affordable housing programmes is that they offer wraparound support particularly in relation to financial management. In an affordability context, the path to home ownership can be a long one. Without adequate support the process can unravel leaving both households and the sponsor in potentially worse positions than when they started.

A potential failing of some approaches to affordable housing is that they focus on delivering brand new homes and a narrow range of typologies and locations, which may not suit all households. Any strategy should ideally facilitate entry into a diverse range of affordable housing.

The examples outlined below are predicated on the Crown acting as the primary sponsor. In our view, however, there is considerable scope to introduce market or Community Housing Provider (CHP) participation and risk sharing into these models.

Potential Progressive Home Ownership options include:

1. Direct Crown Funding Support

This type of housing support is not new. Post World War II, New Zealand facilitated the purchase of affordable housing with attractive finance packages administered by the State Advances Corporation. There is no reason why a modern version of this scheme could not be reintroduced.

The provision of medium to long term, low or no interest rate, advances from the Crown to the homeowner, coupled with the equity contribution of the homeowner and traditional bank lending packages, would facilitate housing affordability by bridging both the deposit and the debt servicing gap which typically confronts first home buyers.

The Crown would retain a security interest in the property (typically a second mortgage). This would be subordinated to the primary lender. The intention is that over time the Crown's advance is repaid in full and the proceeds are able to be recycled. This will likely be facilitated by long term growth in the value of the property, amortisation of the bank's advance and improved household earnings over time.

To be eligible, the home buyer must first meet pre-qualification hurdles, essentially proving a household income below certain thresholds and, in some cases, displaying an acceptable credit history.

Pros	Cons
Simple to implement and administer.	Banks may utilise the advance to reduce their risk while providing no additional funding capacity – this would have to be managed.
Relatively easy to partner with banks for facilitating delivery and oversight.	Potential risk of loss of capital as a result of default or market downturn.
Advance retained as an asset by the Crown.	Ultimate repayment may be more reliant on capital appreciation, rather than improved debt servicing.
Facilitates direct and rapid stimulus for the housing market in times of need.	The current low interest rate environment indicates that zero interest rate would be required suggesting that the cost of capital would be a direct cost to the Crown.
Facilitates first home buyers to buy either new or second-hand stock and in a typology which best suits their individual circumstances.	
May be attractive to not-for-profit or philanthropic sector in terms of scalability. Potential for attractive tax structuring.	

A variant of this concept is an effective finance mechanism reflecting a '**benevolent' ground lease model** which is effectively structured as a form of vendor finance.

Under this structure, a dwelling is sold with a perpetual ground lease in place. The ground rental is set at zero over an initial period of, say, five years and on expiry of the rent free period, the homeowner would have the option of either:

- freeholding the property by paying the difference between the leasehold and freehold price (pre-agreed when the lease is signed), or
- continuing to lease the property on the basis of a pre agreed ground rental structure, likely at a relatively low percentage of the market value for the land or an alternative mechanism that is not linked to land inflation.

The homeowner retains into perpetuity the option (post, say, year five) to either freehold the property at valuation or to sell the leasehold interest to a third party.

This structure has the potential to provide a more robust security structure for the developer/sponsor and a lower initial household home ownership cost.

Pros	Cons
Effectively zero cost vendor finance to the homeowner for five years.	Leasehold structures may be perceived as tainted given Cornwall Park Trust type arrangements.
The Crown's interest in the property is secure and protected, and the homeowner has security of tenure.	Coupon results in a negative Net Present Value (NPV) for the sponsor, albeit this is better than an outright grant or wealth transfer.
The leasehold interest is retained as an asset by the sponsor until such time as the property is freeholded.	Under adverse market conditions this structure provides the homeowner with the ability to either freehold the property or remain as a long-term tenant.
Facilitates choice of options and outcomes for households, who can choose their home from either new or second-hand stock which best suits their individual circumstances.	Potential risk of loss of capital to the sponsor as a result of default or market downturn.
May be attractive to not-for-profit or philanthropic sector in terms of scalability. Potential for attractive tax structuring.	Ultimate repayment may be more reliant on capital appreciation rather than improved debt servicing.
Responsibility for the dwelling and all improvements lies with the homeowner.	

2. Rent-then-Buy/Own

This is effectively another financing instrument. In the case of Rent-then-Buy/Own, medium to long term leasing agreements provide the household with the right to acquire the property at the end of a pre-set rental period.

There are a number of structuring options. Some schemes are structured so that a portion of rent is allocated to building savings (equity); others are focused on capital appreciation of the property to generate equity (to convert to ownership) over time.

Where part of the rent is allocated to building savings, rent is typically set below market. Tenants that have a KiwiSaver account or other saving mechanisms are over time able to bolster existing equity and ultimately establish sufficient equity for a deposit to buy the property outright.

In the event that a household cannot buy their home outright, there may be potential to convert the property to a shared equity type scheme (see below).

There is a similar, but alternative, model structured to attract (cost effective) institutional (rather than pure development) capital to affordable housing. It anticipates an underwrite from the Crown in the form of a put option from the developer to the Crown in the event that a rent to buy/own candidate cannot step into ownership. If the put is exercised, the Crown would pay a value typically consistent with a cost plus model, and could on sell the unit or convert it into social housing.

Pros	Cons
The sponsor's interest in the property is secure and protected while the homeowner has security of tenure.	Potential risk of loss of capital to the sponsor as a result of default or market downturn.
Facilitates choice for households, who can choose their home from either new or second-hand stock which best suits their individual circumstances.	Ultimate repayment may be more reliant on capital appreciation rather than improved debt servicing.
May be attractive to not-for-profit or philanthropic sector in terms of scalability. Potential for attractive tax structuring.	In the event that a leasehold structure is advanced, regardless of structure, these structures are somewhat tainted noting that land inflation created affordability challenges for 'traditional' Glasgow-style leases established (mostly) last century.
Variant model exchanges Crown's contribution for a contingent liability if desired.	

3. Shared Equity Mechanism

In simple terms, this model assumes that a developer (or some step-in party) sells a proportion (in essence, a fractional interest) of a property to a first home buyer, retaining an equity interest until they can build their equity and refinance to acquire 100% ownership of the property. The process of the buyer building equity to be able to secure 100% ownership is commonly known as 'stair-casing'.

This model is typically applied to newly built homes, but it could be applied to secondhand stock.

To be eligible, the home buyer must first meet pre-qualification hurdles, essentially proving a household income below certain thresholds and, in some cases, displaying an acceptable credit history. Typically, the homeowner contributes between 60% and 80% of the home's market value, financed by providing a deposit (typically at least 5% of market value) and taking out a mortgage to fund their share of purchase price. The shared equity partner owns the balance of the property and the ownership arrangement is generally as 'tenants in common'.

The homeowner is often required to pay a return on the shared equity partner's capital on the basis of a discounted coupon (or interest rate). This is not always the case and in sometimes no coupon is payable.

The homeowner pays all outgoings and is required to buy out the shared equity partner within a prescribed time frame (typically 10 years), or earlier, based on valuation.

Where the homeowner has not been able to, and cannot, buy out the shared equity partner, the property is typically placed on the market for sale. The proceeds are split pro-rata, relative to the equity share established when the house was acquired.

Pros	Cons
Shared equity component is retained as an asset by the Crown.	Relatively more complex to establish and administer.
Potential for the Crown to receive some capital gain and potentially interest on its capital.	Potential risk of loss of capital as a result of default or market downturn.
Facilitates choice for households, who can choose their home from either new or secondhand stock which best suits their individual circumstances.	Ultimate repayment may be more reliant on capital appreciation rather than improved equity and/or income to facilitate refinancing.
May be attractive to the not-for-profit or philanthropic sector to support the Crown's activities, and increase scalability. Potential for attractive tax structuring.	Exposes the Crown to an element of risk and cost associated with the upkeep of the dwelling and other improvements.

4. Full Leasehold Structure

The leasehold model, which incidentally was originally structured to support delivery of affordable housing, has potential to be applied on the basis of a long-term leasing structure, rather than simply acting as a funding mechanism as referenced above.

It would involve the first home buyer acquiring a 'right to occupy' (or similar) the improvements on the land (the house) via an upfront payment and then renting the land into perpetuity from the developer/sponsor.

The first home buyer pays an annual ground rent for use of the land. This is set well below market value and only ever increases annually with underlying inflation (and may be linked to an 'affordable', rather than economic, rent) as opposed to property/land inflation, for the period the household remains in the programme. It can trade the value of the right to occupy.

This ensures the initial purchase price and ongoing ground rent remain affordable for the household and successive purchasers, into perpetuity.

Pros	Cons
Provides a long-term asset to the Crown whilst enshrining the affordable nature of the property into perpetuity.	Leasehold structures, regardless of structure, are somewhat tainted noting that land inflation created affordability challenges for 'traditional' Glasgow-style leases established (mostly) last century.
Facilitates choice for households, who can choose their home from either new or second-hand stock which best suits their individual circumstances.	Rental mechanism requires careful consideration to ensure that rental reviews do not result in rental becoming unaffordable.
May be attractive to the not-for-profit or philanthropic sector to support the Crown's activities, and increase scalability. Potential for attractive tax structuring.	

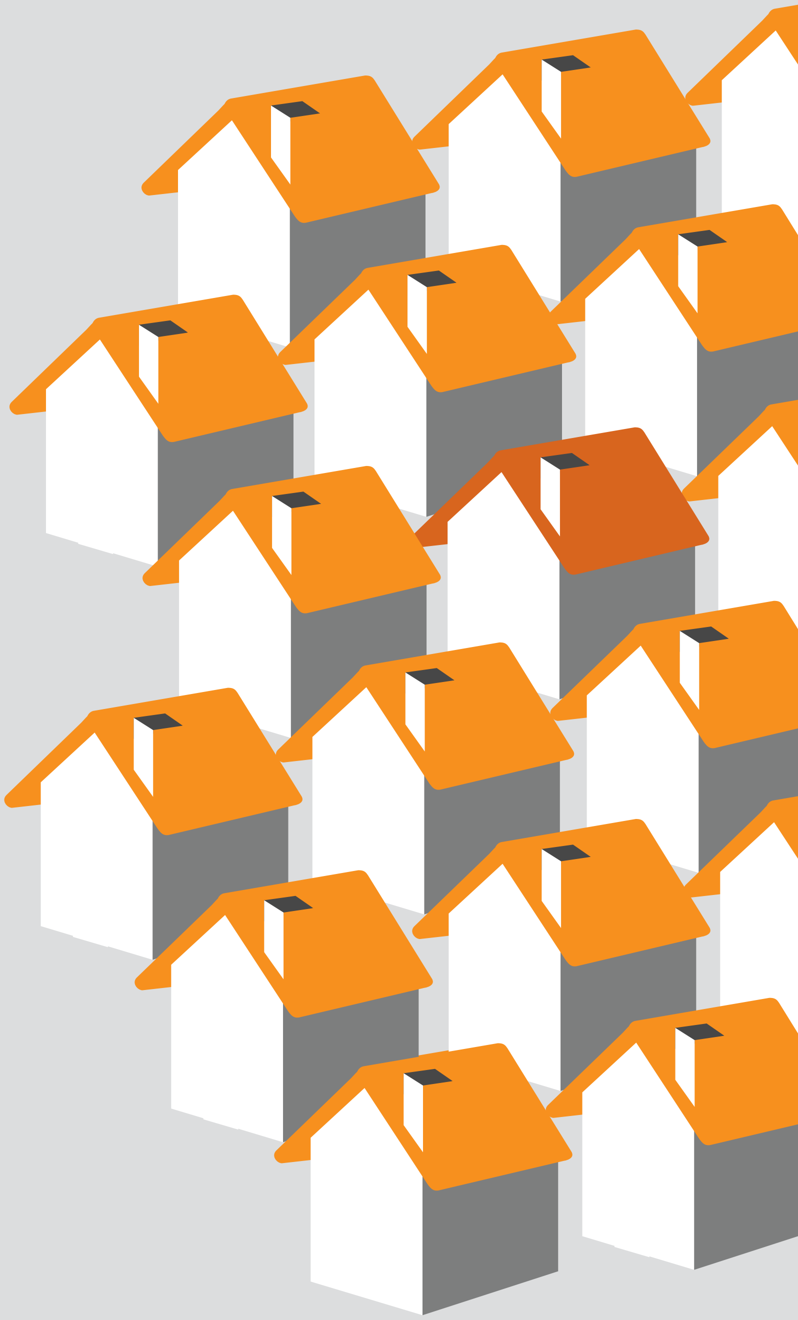
Whichever Progressive Home Ownership approach the Crown advances, it should ideally meet the key criteria of being scalable and sustainable, delivering low cost outcomes, and be equitable and meaningful to first home buyers.

How PwC can help

PwC New Zealand's Real Estate Advisory team combines experience and knowledge with the tools and resources of the PwC network.

Whether you need help with property advisory, transaction structuring and execution, corporate real estate strategy planning, representation as a tenant, litigation support, project leadership or anything in between, we have the people to help.

With deep insight of the local property market, we're confident we can advise you on any real estate enquiry.



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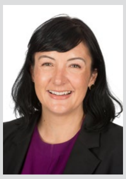

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