2. STRATEGIC HOUSING REVIEW

Type of Report:	Operational
Legal Reference:	N/A
Document ID:	1412891
Reporting Officer/s & Unit:	Natasha Mackie, Manager Community Strategies

2.1 Purpose of Report

This report summarises the Strategic Housing Review findings and seeks approval to undertake a Special Consultative Procedure on the three options outlined.

Officer's Recommendation

The Napier People and Places Committee:

a. Resolve to undertake a Special Consultative Procedure based on the attached Statement of Proposal (*Doc Id 1426519)* on all three options with no preferred option identified

b. Note that further consultation may be required dependant on the decision made following this consultation.

2.2 Background Summary

Council started providing community housing over 50 years ago when, like many councils around the country, it received government low cost loans to build housing units. Of the 377 units we now have, 80% are for retirees or people with a disability. Council housing is for people who need affordable homes and who are able to live independently. The 377 units are spread over 12 villages across the city, on a total of 10.7 hectares. While not considered high density, these homes are in very close proximity of each other. Council supports tenants by providing subsidised rents based on income (set at a maximum of 30% of household income). A team within Council manages tenancies including administering tenancy agreements and arranging repairs and maintenance to the units. Asset management and capital projects are also managed in-house.

In 2018, Morrison Low completed a Section 17a of the Local Government Act (LGA) review of the housing activity. Councils are required under the LGA to complete S17a reviews of their activities. Alongside a sample-based condition assessment, the review identified ongoing sustainability issues with the current delivery model and identified two options for Council to consider. These options were to:

a) Divest a number of villages in order to reinvest in the portfolio (offset costs and replace ageing stock), or

b) Partner with a Community Housing Provider (CHP) who could attract market rent through the Government's Income Related Rent Subsidy (IRRS) which is not available to councils, thereby generating more income to offset growing costs.

Following this report, a more detailed assessment of options to retain the housing was undertaken by PwC. This review identified a potential option to sell part of the portfolio to help fund development of two sites that could generate additional income to fund the remaining portfolio along with a rent increase. This option introduced a high level of complexity, and therefore risk, to managing the portfolio. Another option identified was to continue as is with the deficits being funded through a ratepayer contribution. Both of these options could include an increase to rents. It also identified a transfer of the portfolio (sale) as the alternative option.

In late 2019, the rent policy was reviewed and rents were increased, but capped at 30% of tenant income. This percentage is a generally accepted level for housing affordability.

With continued forecast deficits, a detailed phase two review was initiated on two options, transfer of the portfolio and a part retain / part sell option and compared with the new status quo (with new rent policy). This review is now complete and the options are detailed below. The PwC report is attached. Some information in the PwC report is redacted due to commercial sensitivity.

2.3 Issue

Council delivery of Housing

As identified above, councils were encouraged to provide housing when the Government provided low-cost loans first in the 1960s and again in the 1980s. These loans saw many councils across the country create housing portfolios. Councils have differing tenant cohorts but traditionally the earlier housing was created for ‘pensioners’ or retirees. Rental policies also differ between councils with many adopting a subsidised market rent policy. Over the last decade, many councils have opted out of providing subsidised housing due to issues of financial sustainability as housing stock has aged and costs to maintain housing has increased.

In 2014, the Government introduced an Income Related Rent Subsidy (IRRS) for registered Community Housing Providers (CHPs). This allows the provider to receive full market rent for a property with the tenant being charged 25% of their income and the remaining rent being topped up to market rent by the government. This enables financial sustainability for existing stock while also being able to increase and/or replace portfolios. Kāinga Ora are also able to access the IRRS.

CHPs and Kāinga Ora are also afforded exemptions or allowances to legislation related to residential rental provision. For example, the Residential Tenancies Act allows them to terminate tenancies should the tenant become ineligible for social housing, and compliance to Healthy Homes standards timeframes are longer.

It would appear, the Government, through current legislation and policies, are not actively encouraging councils to continue to provide affordable housing. However, some councils, are investing heavily in their housing stock and also increasing their portfolios either alone or through partnership arrangements. Responses to our Long Term Plan 2021-31 consultation identify a mixed view from the Napier community on the matter. Consultation on the options identified in this report may provide clearer information to Council on the community view around whether or not the community supports Council continuing to provide a housing service.

Condition of Units

Housing units have been maintained to a reasonable standard. Some medium scale renewal work has been completed e.g. re-roof of units and replacement of unit components (e.g. degraded aluminium joinery) has also been completed. A detailed condition assessment of each of the 377 units was completed as part of this latest review process and it has shown many of the units are nearing or at 'end of life'. The results of the condition assessments identified the capital expenditure requirements for the next 25 years. This expenditure is to maintain current service levels but does not address other 'fit for purpose' issues that arise from the age of the homes not aligning with modern living requirements or accessibility needs. Our current service level is to 'replace at failure', resolve any health and safety hazards and to meet compliance requirements. While the condition assessments are very detailed, and forecasts are based on assessing each component of each unit, the actual point of failure timings may not directly align with forecasts. This means there is a risk that expenditure may be needed sooner (which would increase early deficits) than predicted.

Financial sustainability

While there was some investment from Council when the units were first established, the portfolio has largely funded its costs through rents received from tenants – paid for itself, until this year when funding in reserves was depleted and large forecasted deficits came into effect. In 2021, Council consulted with the community to fund these forecast deficits through loan funding until the Strategic Housing Review was completed and a decision could be made about the future provision of housing.

Loan funding on an ongoing basis cannot be sustained as loan repayments compound each year while deficits also increase.

Retaining retirement villages and selling the three 'social' villages to fund the deficits was considered but not investigated further. While it provides a short term fix, it does not provide a medium to long term solution. This option would reduce income from rents (reduction of 72). The remaining villages will still generate a shortfall once the sale proceeds are used and the position would end up the same as the current situation with fewer units.

The retention options analysed by PwC – Status Quo and Part retain / Part sell identify an approximate $2.2-2.3 million annualised shortfall that require ratepayer and/or tenant (rent) support.

The book value of the portfolio sits at $65 million. This is based on a Telfer Young market valuation as at 20 March 2020. Market valuation represents highest and best use (e.g. capitalised 'market' rent or redevelopment value). However, the transfer (sell) options that best align with Council's criteria (selling to a CHP or Kāinga Ora) would attract a 'discounted cashflow' (DCF) price (lower sale price) based on future forecasted cashflows of the portfolio by any given buyer. This would be materially lower than the market value. In addition, any sale price would be further impacted should any covenants be placed on the transfer e.g. retention of current tenants and the retirement criteria. However, a sale does remove the liability (ongoing deficits). Removing the liability coupled with attaining sale proceeds provides a positive financial outcome for the Council.

Rent Setting Policy

In 2019, the rent setting policy changed to increase the total rental income while also keeping rents 'affordable' (30% of income). This meant that tenants receiving Superannuation or Supported Living Benefits had an increase (5% of their income) and rent for a social village unit was set at 92% of market rent or 30% of the tenant's income, whichever was lowest. The effect of this saw a total increase in rent revenue for the retirement units, but this was largely offset by reduction in the overall rent payable in the social units. Unfortunately, maintaining this income-related rent setting policy will not achieve financial sustainability through tenant income (rent) alone. For either of the retention options to be viable, the rent setting policy will need to change to a subsidised market rent model with market rent valuations reviewed on a regular basis (e.g. every two years) and applied, with CPI adjustments made in the alternate year.

Adopting this policy would have impacts for tenants both in terms of affordability with rents higher than 30% of income in most cases and add uncertainty with changing market rent values. Retirement housing tenants receive an increase in income with annual Superannuation increases and are able to apply for an increase in accommodation supplement if rents increase. Other tenants on low incomes are able to also apply for increases to accommodation supplement as rents increase. Council rentals, even applying a market rental formula, is still significantly lower that the private rental market (e.g. Council 1 bedroom unit - $283 per week versus Private 1 bedroom unit - $345 to $390 per week – source Trademe 21/12/21). This difference could partly be a result of the 'level' of market rent applied. We generally use the lower to median range where private rentals may use the upper range to determine rent.

While there is no legislative maximum rent increase, it is advisable that the rent increases outlined in the Status Quo and Part sell / Part retain options be phased in over a two-year period. Rents can only be increased once every 12 months. For the majority of our tenants these increases can be applied in April of each year, giving 60 days notice.

Meeting demand – additionality

Demand has remained high in the affordable rental market. Our waiting list of over 100 people/households has been closed to new applicants since June 2019. Our occupancy rates remain high with very low turnover. Without capital investment into the portfolio, there is no ability to increase its size. The retirement housing provided by Council is one of the few options available in Napier to those whose income is limited to Superannuation and who have no asset base. This cohort is set to grow as more and more working age people are unable to enter the housing market and either rent through the private market or are supported through public housing.

In Napier, over the next twenty years, based on the latest Census data, this could be as many as 2,430 people. These are the people currently aged 40-64 years of age who rent in the private market and who earn $30,000 or less. Of those who earn $30,000 or less in this age group, 72% are renting in the private market and 25% are in public housing with 1.9% in Council housing. At this level of income and the current rent prices, this cohort is likely to seek the type of rental housing currently provided by Council.

Demand for public housing is high in Napier with 753 on the Housing Register, with 732 of those being in the high priority Category A (as at September 2021). Napier's numbers on the register are the second highest for a provincial city.

Tenancy Management Changes

Tenancy rules changed with the changes to the Residential Tenancies Act (RTA). One of the main changes, the removal of the 90 day no reason termination clause, has introduced complexities for tenancy management and policy eligibility criteria. In order for tenants to access Council housing, they must be below the low income and low asset threshold. We initiated regular eligibility reviews in 2018 which found that on average around 5-8% of sitting tenants no longer met the eligibility criteria. Prior to the RTA changes we were able to manage these situations with the tenant whereby they either resolved their eligibility issue (e.g. reduced their income) or found alternative accommodation. The removal of the 90 day no reason termination no longer provides a lever for us to rectify eligibility issues. However, our policy does provide for the charging of full market rent should the tenant become and remain ineligible. This creates a situation where ineligible tenants are able to remain in housing potentially subsidised by ratepayers while those in need remain on our waiting list.

A priority placement process was introduced in 2019 so people with a high need for housing were placed first as opposed to being 'first in' on the waiting list. This has meant that tenants are often experiencing more complex situations which can be challenging in 'close proximity' living arrangements. Dealing with neighbourhood tension and tenant behaviour under the RTA changes has required a higher level of administration and management oversight.

These tenancy management issues, along with the growing compliance and asset management requires additional resource allocation should the portfolio be retained or until any transfer can be completed (a minimum of one extra staff member in the tenancy team).

Legal

Two village sites are listed in Schedule 3 of the Napier Borough Endowments Amendments Act 1999 (amendment of the 1876 Act).These villages are Carlyle Place and Hastings / Munroe. Both parcels of land were transferred to Council from the Crown and were originally in Māori ownership prior to their transfer to the Crown. The option to Part Retain / Part Sell identifies Carlyle Place for divestment and the option to Transfer (sell all housing) identifies both Carlyle Place and Hastings / Munroe for divestment. A high level review of the legislative and contractual obligations conducted by PwC (Legal), given these option pathways, identified that both sites are subject to the requirements of both the Napier Borough Endowments Act 1876 (NBEA) and Local Government Act 2002 (LGA). They are also subject to the terms of the registered endowment instruments and the historical endowment agreements themselves. Where Council originally acquired the sites from the Crown, there may also be Public Works Act 1981 obligations.

The legal review concluded that:

"there were legally compliant pathways available for each of the proposed options. Importantly, there are strategy options and implementation pathways that are potentially able to preserve, and make workable the spirit and intent of the original endowment purposes (some of which are currently ineffective) which focus on benefits to the community."

In addition, PwC advised that although not strictly required under the legislation, where sites are identified as having been in iwi ownership (prior to transfer to the Crown and then Council), consultation with mana whenua is recommended to preserve iwi environmental, cultural and heritage values in the sites and this also provides an opportunity for meaningful consultation and partnership.

Any development will require regard for 'Sites of Significance' to Māori. The Hastings / Munroe site is situated in such and area and would therefore necessitate consultation with appropriate Māori entities.

The divestment options (Part Retain / Part Sell or full transfer) involve a Strategic Asset and could only be actioned if provided for in an LTP. Therefore, if either of these options were selected as the Council's decision, further consultation would be required through the next LTP process or an LTP amendment to the current LTP.

Should the Status Quo option be selected as Council's decision, involving a rates impact, this would need to be informed to the community through an Annual Plan consultation process, with the next available Annual Plan process being the 2023/24 year. The Annual Plan 2022/23 process will be underway prior to the decision. If this option were selected as the decision funded solely by rent increases, the Residential Tenancies Act applies with a 60 day notice period for rent increases being required, so could be implemented immediately.

There are no substantial contractual arrangements that would be affected by proceeding with any of the options.

2.4 Significance and Engagement

This matter requires a Special Consultative Procedure as part of the decision-making process because it involves the potential transfer of ownership (and control) of a Strategic Asset. In addition, the matter is deemed significant given that the potential decision could:

- have ongoing significant increases to rates which require changes to key financial policies and settings e.g. Revenue and Financing Policy and rates caps (retention of portfolio with loan funding the gap)
- be difficult to reverse or be irreversible (transfer of portfolio)
- change the levels of service (all options)
- impact on affected individuals - tenants (potentially all options)
- significantly impact on rating levels (retention of portfolio)
- financially impact Council's resources – e.g. balance sheet, proceeds of sale and income reduction (transfer of portfolio)
- have significant decision costs (all options will incur costs to implement)

Council's decision around the future provision of its housing will be of high interest to key stakeholders including mana whenua, iwi and post settlement governance entities (PSGEs), Māori service providers, the Crown and its relevant agencies, potential purchasers and developers, Community Housing Providers (CHPs), community support service providers and other councils. Direct engagement with key stakeholders will be undertaken alongside wider community engagement on the matter.

As affected individuals, tenants will be consulted utilising a range of approaches in order for each tenant to be able to engage in the process. Tailored information will be provided to each tenant on how the options would directly impact them (e.g. rent rates etc).

A High Level Consultation Plan is attached.

2.5 Implications

Financial

As outlined above the current model of funding and delivery of the housing activity is not sustainable. Deficits are being funded by loans with future ratepayers funding present costs and services. The Long Term Plan 2021-31 consultation identified loan funding as a short term measure to deal with the shortfalls until the Strategic Housing Review was completed and a decision could be made on the future provision of housing.

All options identified each have financial implications.

The options that have Council retain the housing would require changes to current financial policies and strategies, particularly the revenue and financing policy (how rates are set) and rates caps. The rent setting policy will require changes unless deficits are fully funded directly by rates.

Transfer options will take time to complete necessitating further loan funding and/or rates increases to cover the intervening period.

While there has been detailed financial modelling completed through the PwC analysis, there are still a range of variables that can affect each option including cost escalations, market value changes, changes to the timing of capital expenditure (asset failure), costs to implement and costs around legislative change. While these variables could affect the specific financial detail, the underlying premise of each option remains.

Social & Policy

Secure and affordable housing is considered a key driver of wellbeing. Poor housing is linked to reduced health, education and associated outcomes. In addition to the tangible effects related to the physical home, improved wellbeing is also related to sense of belonging, connection and autonomy. Secure housing allows whānau to establish a home, a base from which to establish social supports and networks and to improve social and economic mobility. Inadequate housing has ripple effects across our community from higher levels of homelessness, increased demands on health and education systems and higher prevalence of social issues.

In New Zealand, a large proportion of public/social housing is provided by the Government, either directly through Kāinga Ora and Ministry of Social Development or indirectly through CHPs. Councils often aim to provide for housing needs that aren't met by the other main social housing providers such as Kāinga Ora. In Napier, Council provides around 10% of the public or social housing available. It is estimated around 90% of current tenants would be able to access public housing from other providers.

Previously, although subsidised rents have been provided, the Napier ratepayer did not directly subsidise this activity. However, with rates funding now being provided, and set to increase substantially to maintain the provision of housing, consideration of continuing this activity is required given that the direct benefit of this activity is low across ratepayers and high for individuals (tenants).

1.6 Risk

Changes to Local Government Provision of Services

There are two key pieces of reform work that could significantly affect local government service provision – 3 Waters and the Future of Local Government.

Should 3 Waters provision be aggregated to new regional bodies, there will be an effect on Council's asset base and its income. While the option to retain housing (with rates contribution) won't cost any more, the proportion of rates spent to subsidise housing would be greater – the overall income pie would be smaller.

The Future of Local Government reform focus is on what the appropriate role and functions of local government should be given its contribution to community wellbeing and its close connection with local communities. The transfer option may diminish Council's status should more emphasis be placed on councils taking a greater role in the provision of housing in the future. A draft report on the reform for public consultation is due in September 2022. This should provide information on the direction the government may take with the reform and allows for adequate time to adjust the decision made by Council in May / June 2022 before implementation becomes irreversible.

Changes to Government Support

Successive governments led by both the National Party and the Labour Party have not made any changes to allow councils to access the Income Related Rent Subsidies (IRRS) that are available to Community Housing Providers and Kāinga Ora. Local Government

NZ, prompted by councils across the country, has submitted several remits to change this policy. These have been unsuccessful. Current communication on the matter indicates no changes will be made to the policy. Access to the IRRS has been identified as the key factor that would allow the Council to continue providing housing.

Ministry of Housing and Urban Development (MHUD) is examining the pressures on councils to continue to delivery housing. We have contributed some of the PwC review information to this work. In discussions with MHUD, they have been very clear that this work in no way changes the IRRS policy setting and that currently the public housing funding has a strong emphasis on new builds.

Information Currency

Financial information is based on current pricing and other assumptions are identified under each option within the PwC report. The changing nature of the construction industry will have an impact on costs, access to materials (supply chain) and capacity to deliver (labour constraints) – this is an issue for every option that has the Council retain some form of ownership.

Other variables that could impact on the currency of information include any delays in consultation or decision-making and subsequent delays in implementation. If these delays are significant, updates to the financial modelling may be required.

It has been difficult to source details around the funding of the initial development of the housing apart from amounts and funding sources. There appears to be no conditions on the donation provided by Henry Charles who contributed funds for a Hall and some housing units. The information we have relied on is what is held in Council's archives. There may be information held in the community that may come to light as part of the consultation process, which may have an influence on decision-making and can be dealt with as part of that process.

Tenant Welfare

This process was initiated in 2017 and has required two subsequent reviews to achieve the level of detail required by decision makers. The length of time and uncertainty has had an effect on some tenants who have communicated a level of anxiety for their future. In addition, some misinformation has also been unsettling. Communication with tenants has been maintained and information and progress updates have been provided throughout the review process. In Council's last two Long Term Plan consultation processes, the housing situation has been outlined.

In August 2021, a meeting was held for tenants where assurance was provided by the Mayor that tenants would not lose their housing. Tenants have been consistently advised that any options that significantly change the provision of housing would require direct consultation with them.

The Housing Team continue to be available to discuss any concerns about the review and targeted consultation is planned as part of the next steps in this review process.

2.6 Options

The options available to Council are as follows:

a. Identify a proposed option and undertake Special Consultative Procedure to inform the decision-making process

b. Present the feasible options identified below and undertake a Special Consultative Procedure based on the attached Statement of Proposal to inform the decision-making process (preferred)

2.7 Development of Preferred Option

Proceed with consultation on the options outlined below:

1.Status Quo	2.Part Retain / Part Sell	3.Transfer (Sell)
Deficit funded by: (a) Rates only (b) Subsidised rents (c) Combinations - Rates and subsidised rents	Deficit funded by: (a) Rates only (b) Subsidised rents (c) Combinations - Rates and subsidised rents	Potential buyer: • CHP • Kāinga Ora • Regional Housing Trust • Open market

1. Status Quo

Description:
The Status Quo option sees Council continuing to provide housing at current levels of service.

This option generates an annualised deficit of $2.2 million and without any rates or increased rent adjustments the accumulated cash shortfall would reach circa $70 million after 25 years (2046).

Ongoing loan funding to fund long term deficits is not considered a feasible option.

In order to cover this deficit, income from rates or rents (or a combination) is required. Key benefits of this option include the relative ease of implementation, retention of housing (and land) in Council ownership and a higher level of certainty for tenants. Moving to a subsidised market rent policy will provide predictable income and reduce the administrative requirements that income-related rent settings cause.

This option does not provide for additional housing to meet growing demand, or upgrades to existing housing to meet modern living standards or accessibility. This option does not address the issue of the units being very close to ‘end of life’ and while replacing componentry will extend the life and buys some time, ultimately decisions on full replacement may still be needed in the future. In addition, the actual capital expenditure may vary from the forecasts, and should they arise earlier, would be challenging given the lack of cash reserves and the time needed to build these up.

Combined contribution
When considering how an activity is funded, i.e. through rates or user pays or a combination of these, Council must consider the proportion of benefit received from the activity and therefore how the cost should be fairly split. This is determined by a series of assessments required by Section 101A of the LGA.

The table below shows examples of rates / rents splits, actual splits may differ following the completion of the assessment and the Revenue and Financing Policy may be affected.

A change in the rent setting policy is advocated under this option. This requires a change from rent being based on a tenant income affordability and moving to a subsided market rental approach. Any initial significant rent increase could be phased in over two twelve month periods. Full rent increases would then be effective from April 2024. Deficits up to April 2024 could continue to be funded through loans as outlined in the Long Term Plan 2021-31. The rent setting policy would form part of the implementation process with the intention to undertake market rental valuations every two years and applying a CPI increase in the alternate year.

While rent increases may potentially be unpopular with current tenants, and in some cases unaffordable, the opportunity for the housing to remain with Council may outweigh these concerns.

The tenancy management issues outlined above require additional staff resources in order to comply with legislative requirements and tenancy matters, this is not currently factored in to the costs.

The following table shows the impact on rates and/or rents depending on the contribution settings. The splits are provided as examples only.

<table>
<tr><td colspan="4">Status Quo – 377 units - $2.2 million deficit pa</td></tr>
<tr><td>Contribution Level to meet deficit</td><td>Ratepayer pays*
(rates increase)</td><td>Tenant Retirement Pays
(rent increase pw) **
Current rent is $127
45% market rent</td><td>Tenant Social Pays
Current rent $151
39% market rent***</td></tr>
<tr><td rowspan="7">100%</td><td rowspan="7">3.1% or $85per annum</td><td colspan="2">Deficit split by tenant type – ‘break even’</td></tr>
<tr><td>78% market rent</td><td>63% market rent</td></tr>
<tr><td>70% or $88pw increase
($215 rent pw)
(51% of tenant income)</td><td>61% or $92pw increase
($243 rent pw)
(32% of tenant income)</td></tr>
<tr><td colspan="2">Increase to 92% market rent</td></tr>
<tr><td>100% or $126pw increase
($253 rent pw)
(58% of tenant income)</td><td>136% or $205pw increase
($356 rent pw)
(47% of tenant income)</td></tr>
<tr><td colspan="2">Deficit split equally across tenants</td></tr>
<tr><td>88% or $112 increase
($239 rent pw)
85% of market rent
(56% of tenant income)</td><td>74% or $112 increase
($263 rent pw)
93% of market rent
(35% of tenant income)</td></tr>
<tr><td>50/50</td><td>1.6% or $43pa</td><td>44% or $56pw increase
($183 rent pw)
66% of market rent
(43% of tenant income)</td><td>37% or $56pw increase
($207 rent pw)
73% of market rent
(27% of tenant income)</td></tr>
</table>

60/40	1.9% or $51pa	35% or $45pw increase ($172 rent pw) 62% of market rent (41% of tenant income)	30% or $45pw increase ($196 rent pw) 69% of market rent (26% of tenant income)
40/60	1.3% or $34pa	53% or $67 increase ($194 rent pw) 70% of market rent (46% of tenant income)	45% or $67 increase ($218 rent pw) 77% of market rent (29% of tenant income)
*Average annual rates increase per rateable property **Based on a single person in a one bedroom unit ***Based on an average of the market rent for 1,2,3 bedroom units			

2. Part Retain / Part Sell

Description:
This option retains 301 retirement units in 8 villages. It loses 76 houses and builds 49 new units. It proposes to transfer the three social villages to another entity with sale proceeds to contribute to the development of 49 new units. The new development would take place on existing sites.

The Hastings/Munroe village would demolish the four units and replace 11 new units that would be rented at full market rent, thereby generating an ongoing income to contribute to the costs associated with the remaining housing. The second site, Greenmeadows East, with land already set aside for additional Council housing, would see the development of 38 new units.

The 72 houses in the three social villages would ideally transfer to a CHP and therefore retain them as affordable rentals for the city. However, with the lack of ability to add new units on these sites, CHPs may not find these villages attractive given the delays in receiving IRRS and the inability to attract the government support available for additionality.

The sale of the Carlyle Village has added complexity due to its inclusion in the Napier Borough Endowment Act. The Carlyle Village is identified as a 'Site of Significance' to Māori having been part of the Pukemokimoki site, a site of particular significance to Ngāti Pārau. Particular regard for 'Sites of Significance' is needed should any development be proposed. The Carlyle Village has not been identified for development in any of the options being considered. The Hastings/Munroe village also sits in a wider 'Site of Significance' area, Te Ahi o Te Waru (the fires of Te Waru). Given its potential for development, engagement with mana whenua is vital to understand any implications for development, opportunities for cultural expression and a potential partnership approach. The site has been significantly modified already but will likely require archaeology oversight during any development process.

While the new units will attract a higher asset value, with the sale of 72 units, the overall asset value for the total portfolio is either likely to decrease or maintain current value. It is unlikely to increase the asset value significantly (e.g. sell at value of $16.2m, new builds with a conservative value of $21.96m (costs to construct) - positive balance of $5.76m).

Key benefits of this option include the refocus of the portfolio to be providing for retirees or those with a disability only, its retains the majority of the housing and land in Council ownership with a higher level of certainty for retirement tenants and it adds new fit for purpose housing to the portfolio.

The sale of the three villages would impact the current tenants in these villages, and depending on the buyer could either have a positive or a negative impact. The preference to retain the housing for community housing would likely result in a positive impact.

The development at Hastings/Munroe creates a higher level income source in the longer term. Moving to a subsidised market rent policy will provide predictable income and reduce the administrative requirements that income-related rent settings cause. The development of the two sites offer potential partnership (and possibly co-funding opportunities) with PSGEs, Iwi and/or Kāinga Ora.

Council currently does not have the resources in-house to implement the development aspect of the option, with the cost of sourcing this function being relatively unknown. The ability to secure consultants and construction contractors is challenging in the current market conditions. Availability of building materials is affecting the supply chain creating project delays and increasing costs.

This option does not fully address the issue of the remaining units being very close to 'end of life', and while replacing componentry will extend the life and buys some time, ultimately decisions on fully replacement may still be needed in the future. In addition, the actual capital expenditure may vary from the forecasts, and should they arise earlier, will be challenging given the lack of cash reserves and the time needed to build these up.

A key challenge with this option is the added complexity and uncertainty regarding both the sale of the three villages and the development aspect. Complexity and uncertainty increase the risk.

This option generates an annualised deficit of $2.3 million and without any rates or increased rent adjustments the accumulated cash shortfall would reach circa $65.9 million after 25 years (2046).

In order to cover this deficit, income from rates or rents (or a combination) is still required. Initially the number of tenants would be lower than the Status Quo option meaning the individual tenant share of the deficit would be higher. The same factors apply to this option as the Status Quo option in terms of tenancy management issues, rent setting policy changes, phased in rent increases (and temporary loan funding) and financial policy reviews.

The following table shows the impact on rates and/or rents depending on the contribution settings. Note that the social village tenants are not included in this table. The splits are provided as examples only.

Part Retain / Part Sell – retains 8 'retirement' villages, develops 45 new units, sells 3 'social' villages - $2.3 million deficit pa		
Contribution level to meet deficit	Ratepayer Pays* (rates increase)	Tenant Pays **
100%	3.3% or $89pa	115% or $145pw increase ($272 rent pw) 96% of market rent (65% of tenant income)
50/50	1.6% or $44pa	57% or $73 increase ($200 rent pw) 71% of market rent (47% of tenant income)
60/40	2% or $53pa	46% or $58 increase ($185 rent pw) 65% of market rent (44% of tenant income)
40/60	1.3% or $36 pa	69% or $87 increase ($214 rent pw) 76% of market rent (51% of tenant income)
*Average annual rates increase per rateable property **Based on a single person in a one bedroom unit Based on 304 units (will vary according to development stage)		

3. Transfer option

Description:
This option would see all 377 units transferred (sold) to another entity.
Council direction during the review process has been to focus on ensuring the housing remains as affordable rental housing. As part of the review at a workshop in October 2020, Council selected a sale or lease option to a CHP to be evaluated in detail as the favoured option for transfer. The protection of tenants and the special character of the retirement villages was identified as important and therefore any transfer contract would need to contain the following covenants:

- Ensure existing tenancies, under the current (or better) terms and conditions, remain in place,
- The portfolio can only ever (in perpetuity) be used to provide housing to retirement or community tenants, and
- The Council retains the right of first refusal (on the same sale conditions) if the buyer was to sell the portfolio.

A market sounding process identified that the option to lease the portfolio would not be attractive. Leasing the portfolio would also not achieve any financial benefit to Council, and would likely exacerbate the current financially unsustainable position.

The opportunities for redevelopment of the two villages identified and the potential to demolish and intensify other currently under-optimised sites allow for additionality which is a key driver to access government funding for CHPs and is a key focus for Kāinga Ora.

Transfer to a CHP

The portfolio would most likely be valued on a discounted cashflow (DCF) basis. In addition, any covenants would negatively affect the overall value. A CHPs DCF might be half the Book Value. There are examples of councils successfully selling their housing to CHPs with covenants including Hamilton City Council.

Transfer to Kāinga Ora

Kāinga Ora is potentially in a better position regarding cashflow as we understand they are able to access the IRRS (full market rent) for existing eligible tenants. A sale to Kāinga Ora might be expected to deliver a sale price similar to, or slightly more than, the value that might be achieved through a sale to a CHP. This may result in a higher purchase price, although there is no guarantee of this given the limited market for this stock and the need for Kāinga Ora only to outbid the next highest bidder.

Transfer to a Regional Housing Trust

There is a potential for the region's councils to 'pool' their portfolios and form a Regional Housing Trust and there is an intention to discuss this further with the other councils to understand the shape of a possible Trust.

There are examples of councils establishing CHPS. Under current legislation, councils and Council Controlled Organisations (CCOs) are excluded from registering as a CHP and securing access to the IRRS. In order to be successful, any Trust would need to be completely independent of Council once established, however Council would be able to influence the purpose and objects of any such Trust. The transfer of housing into this type of Trust would requires councils to 'vest' the assets into the Trust, whereby there would be no sale proceeds back to Council. Council could impose the covenants above on such a transfer.

The transfer options identified above allow the portfolio to continue to support an affordable rental housing approach. These potential options also enable the portfolio to be retained in 'community ownership'.

Advantages of a transfer option to the social housing sector are ultimately financial for both tenants and Council (ratepayers). CHPs provide wraparound support services in addition to tenancy management and are able to apply the IRRS discount rent rate (rent set at 25% of income) to new eligible tenants (tenants coming from the MSD Social Housing Register). Under a transfer to Kāinga Ora, we understand all eligible tenants (existing and new) would be able to access the subsidised rent. Should the covenants be put in place, there would be no negative impact on current tenants. A full transfer would remove all liabilities (forecast costs and deficits).

Sell through the open market

This option is not favoured by Council as it does not align with the review objectives and may result in a loss of affordable rental housing for the city. However, this option would most likely provide a higher sale price more aligned with the current book value of $65 million. A sale through the open market may not afford any protections to current tenants.

Any sale proceeds received (noting a transfer to a Regional Trust would not yield any) would be available for any of the following, in consultation with the community:

- Repay debt
- Invest to generate income
- Pay for current / future loan funded projects
- Implement new or deferred projects

All of the above options have a positive impact for the ratepayer.

The asset would be removed from balance sheet. Council has assets valued at $2 billion (includes $0.5b water assets). While $65 million book value would be removed with the sale of the portfolio, this is not material in of itself to affect Council's ability to raise loans and would still not be an issue should the 3 waters assets also removed.

While direct operational costs would be eliminated, e.g. labour costs, there will be residual internal costs (stranded overheads) that will need to be spread across the remaining business units (departments) requiring a rates contribution. However, if the sale proceeds are invested, there will be no impact as the table below shows.

	Ratepayer*
Residual costs	0.6%
Return on investment of sale proceeds (based on $40m and 2% interest rates)	-1%
Reduced interest rates (paying off loans)	-1%
Net rates saving	-0.4%
*Average annual rates increase per rateable property	

The time it may take for a transaction to be completed could be at least 12 months and should, ideally, be timed to coincide with the beginning of a financial year. Interim funding is required to fund the deficit during the transaction period. The Long Term Plan 2021-31 confirmed funding through loans to account for this deficit in the short term.

The option to transfer the entire portfolio to another entity was recommended by PwC as the most sustainable option available.

Summary of Options – Financial Implications

1. Status Quo – 377 units - $2.2m deficit pa			
Contribution level Rates/Rents	Annual rates impact	Tenant - Retirement rent increase per week	Tenant – Social rent increase per week
100%	3.1%	$88 - $112	$92 - $205
50/50	1.6%	$56	$56
60/40	1.9%	$45	$45
40/60	1.3%	$67	$67

2. Part Retain/Part Sell – retains 8 'retirement' villages, develops 45 new units, sells 3 'social' villages - $2.3m deficit pa		
Contribution level Rates/Rents	Annual rates impact	Tenant – increase per week
100%	3.3%	$145
50/50	1.6%	$73
60/40	2.0%	$58
40/60	1.3%	$87

3. Transfer option		
Impact on rates	Invest sale proceeds	Repay debt
Estimated residual costs	0.6%	0.6%
Return on investment (based on $40m and 2% interest rates)	-1%	
Reduced interest costs		-1%
Net rates saving	-0.4%	-0.4%

2.8 Attachments

1 Draft Statement of Proposal - Council Housing (Doc Id 1425783) *(Under Separate Cover)*

2 High Level Consultation Plan - Council Housing (Doc Id 1426518) *(Under Separate Cover)*

3 PwC - Strategic Housing Review (Doc Id 1426520) *(Under Separate Cover)*

NAPIER CITY COUNCIL
Te Kaunihera o Ahuriri

Statement of Proposal

Council Housing Provision

This Statement of Proposal is prepared in accordance with Section 83 of the Local Government Act 2002.

Have your Say

Before making any final decision, we would like to understand your views and option preference(s).

You can make an online submission at sayitnapier.nz or by completing a hardcopy submission form.

Submissions must be received by 5pm, 20 April 2022.

We also invite you to present your submission directly to the Council by attending the Council Housing Provision Hearing on 18 May 2022, in person or via video link.

Further information
Information including the following reports is available at sayitnapier.nz :
PwC – Strategic Housing Review 1 & 2
Council Paper – Strategic Housing Review

Background

Napier City Council started providing community housing over 50 years ago when, like many councils around the country, we received government low cost loans to build housing units. Of the 377 units we now have, 80% are for retirees or people with a disability. Council housing is for people who need affordable homes and who are able to live independently. The 377 units are spread over 12 villages across the city on a total of 10.7 hectares.

Council supports tenants by providing subsidised rents based on income (set at a maximum of 30% of household income). A team within Council manages tenancies including administering tenancy agreements and arranging repairs and maintenance to the units. Asset management and capital projects are also managed in-house.

Our housing units are now up to 60 years old and are at 'end of life', costing more and more to maintain. Added to this are new costs for us to meet healthy homes standards.

Up until 2021/22, we required all of the housing costs to be funded by the rents received from tenants. However, we identified in 2018 that the income from rents was not going to be enough to cover the growing costs. In April 2021, we consulted with the community on how we could cover the shortfall while we completed an in-depth review on the future of housing provision. In June 2021, supported by the community feedback, Council decided to temporarily fund the shortfall by using a loan.

Key issue
We can't continue to provide housing as we are now. We have a projected average annual shortfall of $2.2m which would reach $70m after 25 years. We are unable to continue to loan fund on an ongoing basis as loan repayments compound each year while deficits also increase, this would mean a significant increase rates year on year without addressing the underlying problem.

Considerations in decision-making
Councils have a part to play to increase community wellbeing. Secure and affordable housing is considered a key driver of wellbeing. Poor housing is linked to reduced health, education and associated outcomes. In addition to the tangible effects related to the physical home, improved wellbeing is also related to sense of belonging, connection and autonomy. Secure housing allows whānau to establish a home, a base from which to establish social supports and networks and to improve social and economic mobility.

Inadequate housing has ripple effects across our community from higher levels of homelessness, increased demands on health and education systems and higher prevalence of social issues.

We understand housing supply is considerably stretched in the public housing, private rental and affordable home ownership sectors. Our waiting list of over 100 people/households has been closed to new applicants since June 2019. Our occupancy rates remain high with very low turnover. The retirement housing provided by Council is one of the few options available in Napier to those whose income is limited to Superannuation and who have no asset base. This cohort is set to grow as more and more working age people are unable to enter the housing market and either rent through the private market or are supported through public housing.

In Napier, over the next twenty years, this could be as many as 2,430 people. These are the people currently aged 40-64 years of age who rent in the private market and who earn $30,000 or less. Of those who earn $30,000 or less in this age group, 72% are renting in the private market and 25% are in public housing with 1.9% in Council housing. At this level of income and the current rent prices, this group is likely to seek the type of rental housing currently provided by Council.

Demand for public housing is high in Napier with 753 on the Housing Register, with 732 of those being in the high priority Category A (as at September 2021). Napier's numbers on the register are the second highest for a provincial city.

Given these factors, the Council has been clear that, ideally it prefers to keep its housing units in community ownership and available for those in need of affordable rental accommodation and, if possible, to see an increase in the supply of this type of housing, albeit potentially by an alternative provider (e.g. Community Housing Provider or CHP).

Provision of residential accommodation has changed significantly in the last decade. The Government supports CHPs to provide social housing and support services and has increased its resourcing for the provision of public housing. Recent legislation has increased costs of compliance and complexity to tenancy management. Councils have been excluded from receiving support (e.g. Income Related Rent Subsidies) and dispensations available to CHPs and Kāinga Ora. This includes the inability to terminate tenancies when households no longer meet the eligibility criteria e.g. income exceeds eligibility maximums.

Delays in dealing with the sustainability issues pose a risk for current and future Councils and will have an effect on achieving a balanced budget and Council's financial viability overall. Delays will also ultimately result in a deterioration of the housing stock to the point where some units may not comply with standards and will not be able to be tenanted.

There is a review underway about the future of Local Government, this may impact the future functions that councils deliver. A draft report on the reform for public consultation is due in September 2022. This should provide information on the direction the government may take with the reform and allows for adequate time to adjust any decision Council makes (May / June 2022) before implementation becomes irreversible.
Council needs to consider impacts to current tenants as well as impacts to ratepayers and the wider community.

When considering how an activity is funded, i.e. through rates or user pays or a combination of these, Council must consider the proportion of benefit received from the activity and therefore how the cost should be fairly split.

Options

Since 2018, two reviews have been undertaken. A Section 17A review (Morrison Low) and a subsequent two phase review by PwC. Details on the review process are attached.

We present three options for community feedback:

1.Status Quo	2.Part Retain / Part Sell	3.Transfer (Sell)
Deficit funded by: (a) Rates only (b) Subsidised rents (c) Combinations - Rates and subsidised rents	Deficit funded by: (a) Rates only (b) Subsidised rents (c) Combinations - Rates and subsidised rents	Potential buyer: • CHP • Kāinga Ora • Regional Housing Trust • Open market

Each option is outlined below and includes a brief description, pros and cons, and financial impacts for tenants and ratepayers.

1.Status Quo

Description:
The Status Quo option sees Council continuing to provide housing at current levels of service. Changes in the Residential Tenancy Act have meant the complexity of providing tenancy management services has increased. Should Council retain the service, additional staff resourcing is required.

This option generates an average annual deficit of $2.2 million and without any rates or increased rent adjustments the shortfall would reach $70 million after 25 years (2046).

In order to cover this deficit, income from rates or rents (or a combination) is required. The table below shows *examples* of rates / rents splits. Should a combination of funding sources be preferred a Section 101A review is required – this would determine the actual splits based on benefit to each party and impacts.

Status Quo – 377 units - $2.2 million deficit pa			
Contribution Level to meet deficit	Ratepayer pays* (rates increase)	Tenant Retirement Pays (rent increase pw) ** Current rent is $127 45% market rent	Tenant Social Pays Current rent $151 39% market rent***
100%	3.1% or $85per annum	Deficit split by tenant type – 'break even'	
		78% market rent	63% market rent
		70% or $88pw increase ($215 rent pw) (51% of tenant income)	61% or $92pw ($243 rent pw) increase (32% of tenant income)
		Increase to 92% market rent	
		100% or $126pw Increase ($253 rent pw) (58% of tenant income)	136% or $205pw Increase ($356 rent pw) (47% of tenant income)
		Deficit split equally across tenants	
		88% or $112 increase ($239 rent pw) 85% of market rent (56% of tenant income)	74% or $112 increase ($263 rent pw) 93% of market rent (35% of tenant income)

4

50/50	1.6% or $43pa	44% or $56pw increase ($183 rent pw) 66% of market rent (43% of tenant income)	37% or $56pw increase ($207 rent pw) 73% of market rent (27% of tenant income)
60/40	1.9% or $51pa	35% or $45pw increase ($172 rent pw) 62% of market rent (41% of tenant income)	30% or $45pw increase ($196 rent pw) 69% of market rent (26% of tenant income)
40/60	1.3% or $34pa	53% or $67 increase ($194 rent pw) 70% of market rent (46% of tenant income)	45% or $67 increase ($218 rent pw) 77% of market rent (29% of tenant income)
*Average annual rates increase per rateable property **Based on a single person in a one bedroom unit ***Based on an average of the market rent for 1,2,3 bedroom units			

A change to the current rent setting formula is required.

The current formula has two rent types:

- tenants receiving Superannuation or Supported Living Benefits – rent is set at 30% of income
- other tenants (in the three social villages) – rent is set at 92% of market rent for the unit or 30% of the tenants income, whichever was lowest.

Annual reviews of income are required in order to ensure rents reflect the 'affordability' (30% income) policy. This process is onerous for tenants as well as staff.

Proposed rent setting formula – Subsidised Market Rent

Move to a subsidised market rent model (% of full market rent) with market rent valuations reviewed on a regular basis (e.g. every two years) and applied with CPI adjustments made in the alternate year. A 92% of market rent setting for all units, creating a consistent and easily administered approach. It is recommended the resulting rent increases be phased in over two years. Full rent increases would then be effective from April 2024. Deficits could continue to be funded through loans as outlined in the Long Term Plan 2021-31.

Retirement housing tenants receive an increase in income with annual Superannuation increases and are able to apply for an increase in accommodation supplement if rents increase. Other tenants on low incomes are able to also apply for increases to accommodation supplement as rents increase. Council rentals, even applying a market rental formula, is still significantly lower that the private rental market (e.g. Council 1 bedroom unit -

$283 per week versus Private 1 bedroom unit - $345 to $390 per week – source Trademe 21/12/21).

Pros:
Key benefits of this option include the relative ease of implementation, retention of housing and land in Council ownership and a higher level of certainty for tenants. It allows full control of the asset and tenancy policies to remain with Council. Moving to a subsidised market rent policy will provide predictable income and reduce the administrative requirements that income related rent settings cause. In the case of tenants funding the full costs, financial impact to the ratepayer could be low in the medium term.

Retaining the housing portfolio places Council in a position to take advantage of potential opportunities any Local Government reform may provide.

Cons:
This option does not provide for additional housing to meet growing demand, or upgrades to existing housing to meet modern living standards or accessibility. This option does not address the issue of the units being very close to 'end of life' and while replacing componentry will extend the life and buys some time, ultimately decisions on full replacement may still be needed in the future. In addition, the actual capital expenditure may vary from the forecasts, and should they arise earlier will be challenging given the lack of cash reserves and the time needed to build these up.

While rent increases may potentially be unpopular with current tenants, and in some cases unaffordable, the opportunity for the housing to remain with Council may outweigh these concerns.

In the case of ratepayer contribution increasing, the financial impact on ratepayers could be significant on an ongoing basis.

2. Part Retain / Part Sell

Description:
This option retains 300 retirement units in 8 villages. It proposes to transfer the three social villages to another entity with sale proceeds to contribute to the development of 49 new units. The new development would take place on existing sites.

The Hastings/Munroe village would demolish the four units and build 11 new units that would be rented at full market rent, thereby generating an ongoing income to contribute to the costs associated with the remaining housing. The second site, Greenmeadows East, with land already set aside for additional Council housing, would see the development of 38 new units. This option loses 76 houses and builds 49 new units. The 72 houses in the three social villages would ideally transfer to a CHP and therefore retain them as affordable rentals for the city. However, with the lack of ability to add new units on these sites, CHPs may not find these villages attractive given the delays in receiving IRRS and the inability to attract the government support available for additionality (building new supply). The sale of the Carlyle Village has added complexity due to its inclusion in the Endowment Act.

The Hastings/Munroe village sits in a wider 'Site of Significance' area, Te Ahi o Te Waru (the fires of Te Waru). Engagement with mana whenua is vital to understand any implications for development, opportunities for cultural expression and a potential partnership approach to any development on this site. The site has been significantly modified already but will likely require archaeology oversight during any development process.

While the new units will attract a higher asset value, with the sale of 72 units, the overall asset value for the total portfolio is either likely to decrease or maintain current value. It is unlikely to increase the asset value significantly (e.g. sell at value of $16.2m, new builds with a conservative value of $21.96m (costs to construct) - positive balance of $5.76m).

This option generates an average annual deficit of $2.3 million and without any rates or increased rent adjustments the shortfall would reach $65.9 million after 25 years (2046).

In order to cover this deficit, income from rates or rents (or a combination) is required. Initially the number of tenants would be lower than the Status Quo option meaning the individual tenant share of the deficit would be higher. The same factors apply to this option as the Status Quo option in terms of tenancy management issues, rent setting formula changes, phased in rent increases (and temporary loan funding) and financial policy reviews.

The following table shows the impact on rates and/or rents depending on the contribution settings. Note that the social village tenants are not included in this table. The splits are provided as examples only.

Part Retain / Part Sell – retains 8 'retirement' villages, develops 45 new units, sells 3 'social' villages - $2.3 million deficit pa		
Contribution level to meet deficit	Ratepayer Pays* (rates increase)	Tenant Pays **
100%	3.3% + $89pa	115% or $145pw increase ($272 rent pw) 96% of market rent (65% of tenant income)
50/50	1.6% or $44pa	57% or $73 increase ($200 rent pw) 71% of market rent (47% of tenant income)
60/40	2% or $53pa	46% or $58 increase ($185 rent pw) 65% of market rent (44% of tenant income)
40/60	1.3% or $36 pa	69% or $87 increase ($214 rent pw) 76% of market rent (51% of tenant income)
*Average annual rates increase per rateable property **Based on a single person in a one bedroom unit Based on 304 units (will vary according to development stage)		

Pros:
Key benefits of this option include the refocus of the portfolio to be providing for retirees or those with a disability only, it retains the majority of housing and land in Council ownership with a higher level of certainty for retirement tenants and it adds new fit for purpose housing to the portfolio. It allows full control of the asset and tenancy policies to remain with Council.

In the case of tenants funding the full costs, financial impact to the ratepayer could be low in the medium term.

The development at Hastings/Munroe creates a higher level income source in the longer term. Moving to a subsidised market rent policy will provide predictable income and reduce the administrative requirements that income related rent settings cause. The development of the two sites offer potential partnership (and possibly co-funding opportunities) with PSGEs, Iwi and/or Kāinga Ora.

Retaining the housing portfolio places Council in a position to take advantage of potential opportunities any Local Government reform may provide.

The sale of the three villages would impact the current tenants in these villages, and depending on the buyer could either have a positive or a negative impact. The preference to retain the housing for community housing would likely result in a positive impact.

Cons:
This option does not provide for additional housing to meet growing demand, or upgrades to existing housing to meet modern living standards or accessibility. This option does not address the issue of the units being very close to 'end of life' and while replacing componentry will extend the life and buys some time, ultimately decisions on full replacement may still be needed in the future. In addition, the actual capital expenditure may vary from the forecasts, and should they arise earlier will be challenging given the lack of cash reserves and the time needed to build these up.

Council currently does not have the resources in-house to implement the development aspect of the option, with the cost of sourcing this function being relatively unknown. The ability to secure consultants and construction contractors is challenging in the current market conditions. Availability of building materials is affecting the supply chain creating project delays and increasing costs.

While rent increases may potentially be unpopular with current tenants, and in some cases unaffordable, the opportunity for the housing to remain with Council may outweigh these concerns.

In the case of ratepayer contribution increasing, the financial impact on ratepayers could be significant on an ongoing basis.

A key challenge with this option is the added complexity and uncertainty regarding both the sale of the three villages and the development aspect. Complexity and uncertainty increase the risk.

Note:
Retaining retirement villages and selling the three 'social' villages to fund the deficits was considered but not investigated further. While it provides a short term fix, it does not provide a medium to long term solution. This option would reduce income from rents (reduction of 73 tenancies). The remaining villages will still generate a short fall once the sale proceeds are used and the position would end up the same as the current situation with fewer units.

3. Transfer option

Description:

This option would see all 377 units transferred (sold) to another entity.

Council direction during the review process has been to focus on ensuring the housing remains as affordable rental housing. As part of the review, at a workshop in October 2020, Council selected a sale or lease option to a Community Housing Provider (CHP) to be evaluated in detail as the favoured option for transfer. The protection of tenants and the special character of the retirement villages was identified as important and therefore any transfer contract would need to contain the following covenants:

- Ensure existing tenancies, under the current (or better) terms and conditions, remain in place,
- The portfolio can only ever (in perpetuity) be used to provide housing to retirement or community tenants, and
- The Council retains the right of first refusal (on the same sale conditions) if the buyer was to sell the portfolio.

A market sounding process identified that the option to lease the portfolio would not be attractive. Leasing the portfolio would also not achieve any financial benefit, and would likely exacerbate the current financially unsustainable position.

The opportunities for redevelopment of the two villages identified in Option 2 – Part Retain / Part Sell, and the potential to demolish and intensify other currently under-optimised sites allow for additionality which is a key driver to access government funding for CHPs and is a key focus for Kāinga Ora. This could make the portfolio attractive to potential buyers.

The time it may take for a transaction to be completed could be at least 12 months and should, ideally, be timed to coincide with the beginning of a financial year. Interim funding is required to fund the deficit during the transaction period. The long term plan confirmed funding through loans to account for this deficit in the short term.

The asset will be removed from balance sheet. Council has assets valued at $2 billion (includes $0.5b water assets). While $65 million book value would be removed with the sale of the portfolio, this is not material in of itself to affect council's ability to raise loans and would still not be an issue should the 3 waters assets also removed.

While direct operational costs would be eliminated, e.g. labour costs, there will be residual internal costs (stranded overheads) that will need to be spread across the remaining business units (departments) requiring a rates contribution. However, if the sale proceeds are invested, there will be no impact as the table below shows.

Transfer – Social Housing Sector	Ratepayer*
Residual costs	0.6%
Return on investment of sale proceeds (based on $40m and 2% interest rates)	-1%
Reduced interest rates (paying off loans)	-1%
Net rates saving	-0.4%

There are three options for transfer that best align to Councils objectives.

Transfer to a CHP

The portfolio would most likely be valued on a discounted cashflow (DCF) basis. In addition any covenants affect the overall value. PwC have estimated the portfolio value on this basis as $34.5 – 47.6 million, which is 53 – 73% of current book value. There are examples of councils successfully selling their housing to CHPs with covenants including Hamilton City Council.

Transfer to Kāinga Ora

Kāinga Ora are potentially in a better position regarding cashflow as we understand they are able to access the IRRS (full market rent) for existing eligible tenants. This may result in a higher purchase price, although there is no guarantee of this given the limited market for this stock.

Transfer to a Regional Housing Trust

There is a potential for the region's councils to 'pool' their portfolios and form a Regional Housing Trust and there is an intention to discuss this further with the other councils to understand the shape of a possible Trust.

There are examples of councils establishing CHPS. Under current legislation, councils and Council Controlled Organisations (CCOs) are excluded from registering as a CHP and securing access to the IRRS. In order to be successful, any Trust would need to be completely independent of Council once established, however Council would be able to influence the purpose and objects of any such Trust. The transfer of housing into this type of Trust would requires councils to 'vest' the assets into the Trust, whereby there would be no sale proceeds back to Council. Council could impose the covenants above on such a transfer. The transfer options identified above allow the portfolio to continue to support an affordable rental housing approach.

Pros:

These potential options enable the portfolio to be retained in 'community ownership'.

Advantages of a transfer option ultimately are financial for both tenants and Council (ratepayers). CHPs provide wrap around support services in addition to tenancy management and are able to apply the IRRS discount rent rate (rent set at 25% of income) to new eligible tenants. Under a transfer to Kāinga Ora, all eligible tenants (existing and new) would be able to access the subsidised rent. Should the covenants be put in place, there would be no negative impact on current tenants. A full transfer would remove all liabilities (forecast costs and deficits). Sale proceeds received (noting that transfer to a Regional Trust would not provide any proceeds) would be available for any of the following, in consultation with the community:

- Repay debt
- Invest to generate income
- Pay for current / future loan funded projects
- Implement new or deferred projects

All of the above have a positive impact for the ratepayer.

Cons:
While the Council is clear it would want to provide protections for current tenants, a change of ownership could create anxieties for tenants.

The transfer of ownership option, once entered into, is irreversible (apart from a future buy-back), and would see the loss of Council ownership of the land. Removing this activity from Council may compromise our position should potential opportunities arise through Local Government reforms or any future government change of policy (that would provide support for Council housing).

The market value of the portfolio sits at $65 million. However, the transfer options that best align with Council's criteria (selling to a CHP) would attract a 'discounted cashflow' price based on future forecasted cashflows of the portfolio by any given buyer. This would be materially lower than the market value. Any sale price would be impacted should any covenants be placed on the transfer e.g. retention of current tenants and the retirement criteria.

Sell through the open market
This option is not favoured by Council as it does not align with the review objectives and may result in a loss of affordable rental housing for the city. However, this option would most likely provide a higher sale price more aligned with the current book value of $65 million. A sale through the open market may not afford any protections to current tenants.

Next Steps

Consultation Opens	16 March 2022
Consultation Closes	20 April 2022
Hearings and Deliberations (Decision)	18 May 2022
Implementation Each option differs in terms on implementation steps and timeframes from implementation within 60 days (Status Quo rents rises) to one year (Status Quo rates rises – informed through Annual Plan consultation). Any sale (part or full) would need to be included in the next Long Term Plan Consultation (2024) or earlier through an amendment to the current Long Term Plan (with consultation). Implementation timeframes for Part Retain / Part Sell would need to account for comprehensive engagement with mana whenua due to the 'Sites of Significance' status.	

Review Process

In 2018, Morrison Low completed a Section 17a (of the Local Government Act) review of the activity. Councils are required under the LGA to complete S17a reviews of their activities. Alongside a sample-based condition assessment, the review identified ongoing sustainability issues with the current delivery model and identified two options for Council to consider. These options were to:

a) Divest a number of villages in order to reinvest in the remaining units, or
b) Partner with a Community Housing Provider (CHP) who could receive market rent through the Government's Income Related Rent Subsidy (IRRS) which is not available to councils.

Following this report, a more detailed assessment of options to retain the housing was undertaken by PwC. This review identified a potential option to sell part of the portfolio to help fund development of two sites that could generate additional income to fund the remaining units along with a rent increase. This option introduced a high level of complexity, and therefore risk, to managing the portfolio. Another option identified was to continue as is with the deficits being funded through a ratepayer contribution. Both of these options could include an increase to rents. PwC also identified a transfer of the portfolio (full sale) as the alternative option.

In late 2019, the rent policy was reviewed and rents were increased, but capped at 30% of tenant income. This percentage is a generally accepted level for housing affordability.

With continued forecast deficits, a detailed phase two review was initiated on two options, transfer of the portfolio and a part retain / part sell option and compared with the new status quo (with new rent policy). This review is complete and this Statement of Proposal presents three options for consultation.

High Level Consultation Plan - Council Housing Provision

Background

Napier City Council started providing community housing over 50 years ago when, like many councils around the country, we received government low cost loans to build housing units. Of the 377 units we now have, 80% are for retirees or people with a disability. Council housing is for people who need affordable homes and who are able to live independently. The 377 units are spread over 12 villages across the city.

Council supports tenants by providing subsidised rents based on income (set at a maximum of 30% of household income).

Our housing units are now up to 60 years old and are at 'end of life', costing more and more to maintain. Added to this are new costs for us to meet healthy homes standards.

In 2018, following a Section 17A review, the issue of ongoing sustainability was identified for the continued provision of housing and an in-depth review process followed. Since 2018, information on the review and its progress, the key issues and potential next steps has been provided to tenants through newsletters, fact sheets and meetings. In addition, the matter has been included in the last two Long Term Plan Consultation Documents, with updates included in Annual Plan Consultation Documents.

In April 2021, we consulted with the community on how we could cover the shortfall while we completed an in-depth review on the future of housing provision. In June 2021, supported by the community feedback, Council decided to temporarily fund the shortfall by using a loan until the review process was completed and a decision could be made on a longer term solution.

Tenants have been advised that this matter is on the Agenda of the Napier People and Places Committee on 3 February and subsequently the Council meeting on 10 March 2022.

Key issue

We can't continue to provide housing as we are now. We have a projected average annual shortfall of $2.2m which would reach $70m after 25 years. We are unable to continue to loan fund on an ongoing basis as loan repayments compound each year while deficits also increase, this would mean a significant increase rates year on year without addressing the underlying problem.

Significance and Engagement Policy

This matter requires a Special Consultative Procedure as part of the decision-making process because it involves the potential transfer of ownership (and control) of a Strategic Asset. In addition, the matter is deemed significant given that the potential decision could:

- have ongoing significant increases to rates which require changes to key financial policies and settings e.g. Revenue and Financing Policy and rates caps (retention of portfolio with loan funding the gap)
- be difficult to reverse or be irreversible (transfer of portfolio)
- change the levels of service (all options)
- impact on affected individuals - tenants (potentially all options)
- significantly impact on rating levels (retention of portfolio)

- financially impact Council's resources – e.g. balance sheet, proceeds of sale and income reduction (transfer of portfolio)
- have significant decision costs (all options will incur costs to implement)

This matter will have the highest impact on the 377 households who are current tenants across the 12 housing villages.

Council's decision around the future provision of its housing will be of high interest to key stakeholders including mana whenua, iwi and post settlement governance entities (PSGEs), Māori service providers, the Crown and its relevant agencies, potential purchasers and developers, Community Housing Providers (CHPs), community support service providers and other councils.

Approach

Consultation will take place from 16 March to 20 April 2022. This meets the four week requirement, accounting for two public holidays (Easter). A Statement of Proposal will be provided along with supporting documentation and will form the basis of consultation material.

As affected individuals, tenants will be consulted utilising a range of approaches in order for each tenant to be able to engage in the process. Tailored information will be provided to each tenant on how the options would directly impact them (e.g. rent amounts etc).

Direct engagement with key stakeholders will be undertaken alongside wider community engagement on the matter.

The consultation period overlaps the Annual Plan 2022/23 consultation. The Housing matter will be referenced in the Annual Plan 2022/23 Consultation Document.

The consultation process will be promoted utilising a range of channels including print, digital, media and tenant meetings.

Online submissions will be strongly encouraged, but hard copy submission forms will be available at a range of sites and provided to tenants.

Statement of Proposal- (SOP)

The SOP provides the three options identified for feedback. The submission form will seek a preferred option, with the opportunity to provide comment on all options, and to provide a general comment or to make other suggestions.

The options are as follows:

1.Status Quo	2.Part Retain / Part Sell	3.Transfer (Sell)
Deficit funded by: (a) Rates only (b) Subsidised rents (c) Combinations - Rates and subsidised rents	Deficit funded by: (a) Rates only (b) Subsidised rents (c) Combinations - Rates and subsidised rents	Potential buyer: •CHP •Kāinga Ora •Regional Housing Trust •Open Market

Communication & Engagement Tools

Tools	**Target**	**Councillor Role**
Communications and Marketing		
Statement of Proposal • Online • Hardcopy	Napier residents	Councillor approval
Summary Information - Website	All of community	
Digital (including social)	Range of demographics All of community	
Print Advertising	As above	
Direct emails	Key stakeholders Peoples Panel	
Media releases	Media	Mayor approval
Engagement Activities		
Targeted Meetings	Tenants only meeting Key stakeholders Mana whenua entities Māori sector / groups	Mayor Wise / Councillor Boag presentation and discussion Mayor and CE led
Community Meeting	Community wide	Mayor Wise / Councillor Boag presentation and discussion

Napier City Council

Community Housing Options

Phase Two - Market soundings, detailed analysis and evaluation

22 December 2021

Natasha Mackie
Manager Community Strategies
Napier City Council
Private Bag 6010
Napier, 4142

Email: natasha.mackie@napier.govt.nz

22 December 2021

Re: Napier City Council's Community Housing Portfolio Options Review

Dear Natasha

In accordance with your instructions as confirmed in our Letter of Engagement dated 30 October 2019 (the "Contract"), we present the findings for phase two of our work, being the analysis of three potential options for Napier City Council's (NCC's) Community Housing portfolio:

- Status quo
- Part retain/part sell (retain retirement villages, sell social villages and redevelop/develop some)
- Transfer portfolio.

This report is an extension of the work completed under phase one of the Contract which was presented:

- In our report dated 24 September 2020 - Housing Provision - Transfer Options Analysis
- To the NCC Councillors October 2020 at the Transfer Options Workshop.

We draw your attention to important comments regarding the scope and process of our work, as set out under the Important Notice and Disclaimers on the following page. Key assumptions made, and information relied upon in respect of this report, are set out in the commentary provided.

You may not make copies of this report available to other persons except as described in the Contract, and subject to the conditions described therein. We will not accept any duty of care (whether in contract, tort (including negligence) or otherwise) to any person other than you, except under the arrangements described in the Contract.

Yours sincerely

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Important notice and disclaimers

Important notice

PwC Advisory Services (PwC) provided a presentation to Napier City Council (NCC) in relation to the Community Housing strategic review in accordance with the scope of services set out in the Letter of Engagement dated 30 October 2019. This report is for the purposes of providing NCC Councillors with a summary of work completed to date and in particular the findings from the market sounding with Community Housing Providers (CHPs), Iwi and Kāinga Ora (KO).

Disclaimers

COVID-19 has now emerged, and continues to evolve, (as at the date of this presentation), as a major economic risk and a risk to the property market. At this stage, it is difficult to take a view on the medium to long term impact of this issue, which at present is highly volatile and uncertain. We have not made any adjustment to our advice in relation to this issue but acknowledge that it may yet become a material consideration.

This document has been prepared for and only for NCC in accordance with the terms of the Contract dated 30 October 2019 and for no other purpose. We do not accept or assume any liability or duty of care (whether in contract, tort (including negligence) or otherwise) for any other purpose or to any other person to whom this document is shown or into whose hands it may come save where expressly agreed by our prior consent in writing or as specifically provided for in the Contract.

The services provided are only to be used for internal decision support. We accept no liability to any party should it be used for any purpose other than that for which it was prepared. We do not permit the services provided to be used for financial reporting or fund raising purposes.

This document is strictly confidential and (save to the extent required by applicable law and/or regulation) must not be released to any third party without our express written consent which is at our sole discretion.

To the fullest extent permitted by law, PwC accepts no duty of care to any third party in connection with the provision of this document and/or any related information or explanation (together, the "Information").

Accordingly, regardless of the form of action, whether in contract, tort (including without limitation, negligence) or otherwise, and to the extent permitted by applicable law, PwC accepts no liability of any kind to any third party and disclaims all responsibility for the consequences of any third party acting or refraining to act in reliance on the Information.

We have not carried out anything in the nature of an audit nor, except where otherwise stated, have we subjected the financial or other information contained in this document to checking or verification procedures.

Accordingly, we assume no responsibility and make no representations with respect to the accuracy or completeness of the information in this document, except where otherwise stated.

The statements and opinions expressed herein have been made in good faith, and on the basis that all information relied upon is true and accurate in all material respects, and not misleading by reason of omission or otherwise.

Where we reference valuation parameters in this report, these should be considered as indicative only and it cannot be relied upon as formal valuation advice. Should NCC seek to transfer the assets, we recommend that independent, formal, valuation advice is procured.

Contents

Definitions

We set out below the definitions of the various cashflow elements that we summarise in this report.

Community Units: Accommodation designated for adults and/or families from the community who fulfil each council's own housing eligibility criteria. Some councils lease a limited amount of their community units at market rates (in an attempt to assist financial sustainability). NCC holds 18 residential properties for strategic purposes. These are excluded from the analysis in this report.

Corporate overhead expenses: costs incurred at the council level which can be partially attributed to the housing portfolio; e.g, IT and specialist staff who spread their time across different departments.

Direct expenses (excl R&M): those operating expenses that are payable whether units are occupied or not e.g. rates, insurance and utilities in shared areas such as common rooms or halls.

Gross revenue: The full amount of rent that is received through the provision of housing tenants. This includes the rent received directly from tenants, any accommodation subsidies and other revenue (e.g rent from community halls within villages).

Liquidity: Refers to the ease with which a an asset can be converted into cash at market price.

Market rent: To estimate 'market rent', we considered the market rents for each site as provided by Telfer Young in their 2020 valuations. We have then added 10% to these figures to reflect the increase in average rents in Napier in the past year.

OPEX: Operating expenses include direct expenses, R&M, other operational costs and corporate overheads attributable to providing the housing service.

Other operational expenses: administrative staff costs and tenancy management fees.

Planned CAPEX: Programmed capital expenditure which includes preventative maintenance designed to maintain the asset's functional lifespan e.g roof replacements, exterior painting, bathroom upgrades, deferred maintenance, legislative works and sinking funds.

Repairs and Maintenance (R&M): day to day general maintenance and service contracts for basic upkeep of the units and grounds.

Retirement units: Accommodation designated to 'seniors' who fulfill each council's own definition of a senior citizen (age criteria across the councils sampled) and who meets the housing eligibility criteria.

Walk-up units: Walk-up buildings are typically two or three-storeys high. These apartment buildings offer predominantly one- and two-bedroom units. Kāinga Ora typically utilises this typology in suburban areas close to town centres to make the most of smaller sites. Their low height means that elevators are not required.

We reference net cashflow on these bases:

- **Net operating income before R&M and planned CAPEX:** The gross revenue less direct expenses (excl R&M), other operational expenses and corporate overhead expenses.
- **Net operating income after R&M but *before* planned CAPEX:**The gross revenue less direct expenses (excl R&M), other operational expenses, corporate overhead expenses and R&M.
- **Net cashflow / Net operating income after R&M and after planned CAPEX:** The gross revenue less direct expenses (excl R&M), other operational expenses, corporate overhead expenses, R&M and planned CAPEX.

Please note:

- **In relation to GST, the information provided and the analysis within this report (unless otherwise stated) includes GST.**

Acronym list

CAPEX	Capital expenditure
CCO	Council Controlled Organisation
HPUDS	Heretaunga Plains Urban Development Strategy
IRRS	Income Related Rent Subsidy
LTP	Long Term Plan
MSD	Ministry of Social Development
NCC	Napier City Council
NPV	Net Present Value
OPEX	Operating expenditure
RTA	Residential Tenancies Act
SPM	SPM Assets

Executive summary

Purpose of this Report

This report forms phase two of a broader scope to identity and consider potential pathways for NCC to nominate sustainable Community Housing services in Napier.

In July 2019, PwC presented a report to NCC providing a strategic review of potential options in relation to the provision of Community Housing. The scenarios considered reflected amended Status Quo options which were tested to establish whether financially sustainable inhouse delivery of community housing was feasible. Our analysis was that 'piecemeal' changes in isolation would not deliver long-term sustainability without significant downsizing of the portfolio. Subsequently two possible strategic paths were identified, either:

- Active management of the portfolio (sell underperforming villages and recycle capital to maintain/improve the balance of the portfolio), or
- Transfer the portfolio.

In October 2019, we were engaged to undertake analysis of these two options and in particular consider respective financial implications, viability and pathways for implementation. The pathways were to establish a framework for NCC to nominate its preferred long-term strategy and way forward for its Community Housing.

This work was undertaken in two phases; phase one identified and presented the various options available to NCC for a transfer (sale, either directly or 'effectively' via a lease) of the portfolio and transfer of management services to an external provider. The findings from this phase of work were presented in our report dated 24 September 2020. In October 2020, a workshop with NCC Councillors was facilitated by PwC. Following this engagement there was a general consensus that the sale or lease of property stock to a CHP was the preferred transfer option to evaluate in greater detail with a proviso that any such transfer must ensure that the portfolio is used for retirement housing in perpetuity with a first right of refusal in NCC's favour if the acquirer ever decided to sell. Additionally, such first right of refusal would be on the basis the value would be established on the same basis as it was sold i.e. established on a Discounted Cash Flow of subsidised rents.

This report presents phase two of our scope of works including our methodology in developing the detailed options and the findings from our detailed analysis of three potential options for the future delivery of Community Housing Services for NCC:

- Status Quo (revised);
- Part retain/part sell (active management);
- Transfer to CHP via sale or lease.

The objective is for Council to select a preferred strategy(ies) and, if applicable, to release the strategy(ies) for public consultation in 2022 with Council ultimately making a decision on the future of its housing portfolio.

Structure of this Report

This report has been structured to:

- Provide an overview of the broader scope and project progression since NCC's initial Section 17A review (under the LGA 2002) in 2018;
- Summarise the findings from the phase one work and the key outcomes including the general consensus of NCC's Councillors from the October 2020 workshop;
- Present our findings from the analysis of:
  - the revised Status Quo option;
  - the part retain/part sell option;
  - our approach to the market, primarily CHPs, to understand the market's appetite to acquire the portfolio (either directly or 'effectively' via a lease) and to ascertain likely key commercial terms.

Within each of the option sections we have set out our:

- Methodology, approach and assumptions;
- Financial analysis;
- Evaluation against the criteria the NCC Councillors worked through at the October 2020 'Transfer Options' workshop when comparing the alternate transfer options to agree the preferred transfer option.

We have then concluded with our key findings identifying the potential pathways available to NCC along with our recommended pathway for NCC to sustainably deliver its Community Housing services in alignment with the City and Community objectives.

Executive summary cont.

Key findings

- **The Status Quo** ensures ongoing security for the current tenants, but at a significant cost to ratepayers. It does not contribute to Napier's growing community housing needs, nor does it support providing fit for purpose accommodation units. We have estimated that over the period to 2046, the indicative cost to the ratepayer to fund the shortfall (to break-even) will be circa $2.2m (excluding financing) per annum.
- **The part retain/part sell** option only marginally improves the cashflow position after 2028 - the cashflow injection from sale proceeds and rent from new units falls short of redevelopment costs. Over the period to 2046, we have estimated the cost to the ratepayer to fund the shortfall (to break-even) will be circa $2.3m (excluding financing).
- In order to achieve financial sustainability under the Status Quo or Part retain/part sell options, policy rent would need to be set at ~74% market rent (equating to ~50% of a retiree's income or 29% of the income threshold* for an individual Community tenant) or ~81% market rent (equating to ~52% of a retiree's income or 30% of the income threshold for an individual Community tenant), respectively. Setting rental policy at these levels would represent a significant increase in rents and would not align with the Council's current objectives of providing affordable housing.
- CHP status and access to Crown funding streams (IRRS and Operating Supplements) are critical for developing a sustainable commercial model that can grow social housing stock and renew the portfolio without creating a burden for ratepayers.
- NCC's portfolio is attractive to CHPs as their focus is to invest in the 'golden triangle' - high growth, high need and fair return. Of the parties approached, purchase was the preferred form of transfer. A leasing model does not enable a CHP leverage for funding for renewal or development aspirations.
- Kāinga Ora has emerged as a potential important shareholder in the community housing sector and may present an alternative to the CHP sector; it is the key government entity with the mandate to deliver on social housing. Whilst Kāinga Ora's key focus is 'Additionality' (ability to provide NEW housing supply), Kāinga Ora did, in March 2021, purchase Nelson City Council's community housing portfolio.
- Whether the portfolio is transferred to a CHP or Kāinga Ora, the Transaction Value would be materially lower than the 'market' value. Market Value represents highest and best use (e.g. the greater of capitalised 'market' rent, or redevelopment value). Both a CHP and Kāinga Ora would assess the transaction value based on discounted cashflow (DCF) analysis of future net cashflow reflecting rental income net of operating and maintenance and CAPEX costs, and with a covenant that locks in community housing into perpetuity, and would not value 'higher and better' alternative use.
- [redacted]
- Transfer via a sale is expected to benefit ratepayers as a result of income returns from reinvested capital or a positive impact from recycling the capital, together with avoided costs equivalent to circa $2.2m and $2.3m per annum.
- Additionally, a transfer to a CHP or Kāinga Ora would benefit the tenants; potentially, eligible tenants for IRRS (we estimate to be 90% of current cohort) would experience a decrease in their rent contribution from 30% to 25% of net income. This benefit would be realised (almost) immediately by the eligible existing tenants with a transfer to Kāinga Ora and to eligible new incoming tenants under a transfer to a CHP.

* The income threshold ($761.50 p/w) is the maximum household income that a tenant is able to earn to be eligible for a council housing unit

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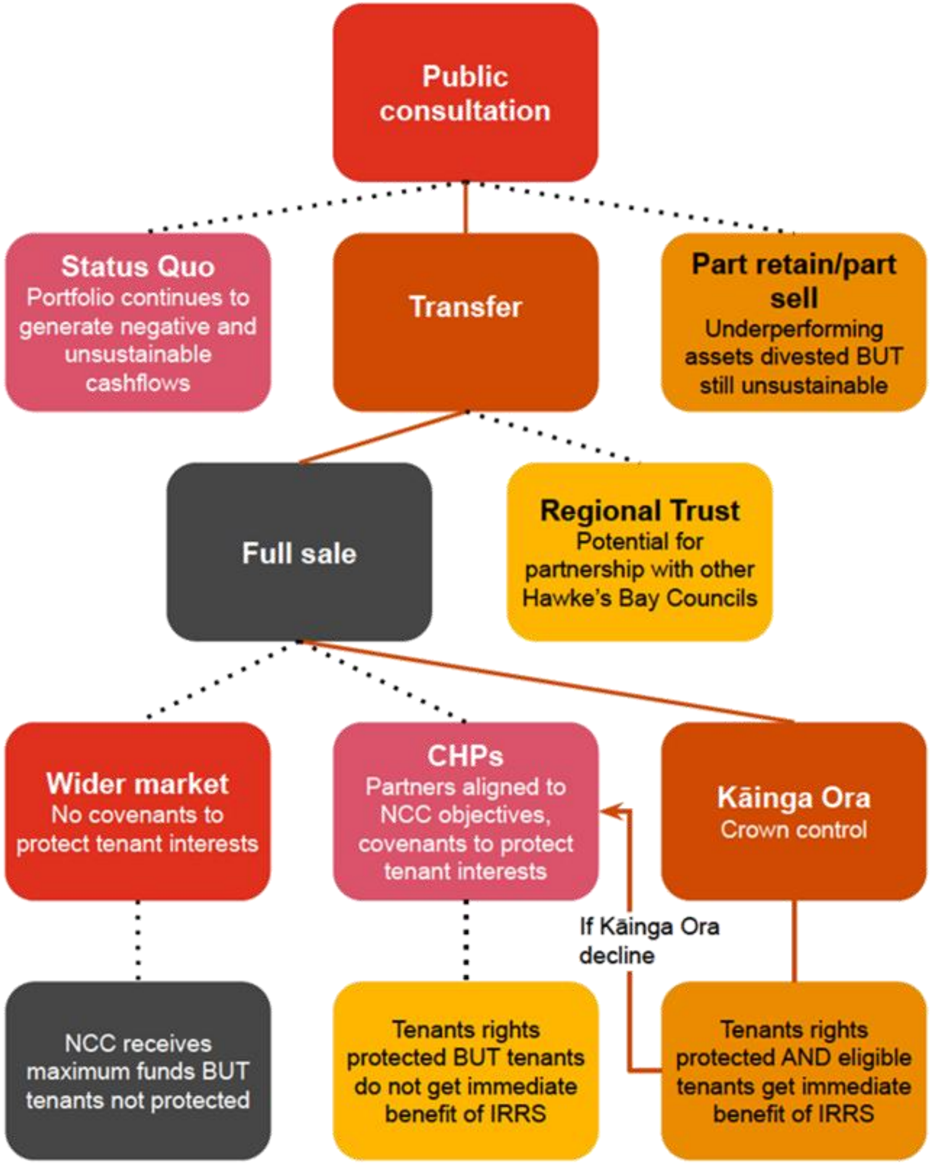
Executive summary cont.

Recommended pathway

NCC has a mid-sized and aging portfolio of housing which requires significant capital investment over the next 25 years with an estimated annualised cost to the ratepayers of circa $2.2m (excluding financing) to meet the shortfall if the Status Quo is retained. Actively managing the portfolio (part retain/part sell option) in-house does not improve the financial position and creates additional complexity. A portfolio transfer by way of an asset sale to an established CHP or Kāinga Ora appears to represent the best value for money option for NCC to meet its community housing objectives. This option is expected to improve tenant wellbeing via access to wrap-around services; structured correctly this option could:

- Provide secure and affordable tenure for council housing tenants;
- Potentially deliver better, 'wrap-around' services for the tenants and potentially improve tenants' financial position with decreased rental contribution relative to their net income;
- Likely facilitate growth in the volume and quality of housing stock within the portfolio through access to Crown subsidies;
- Improve financial outcomes for ratepayers, by transferring an otherwise ongoing liability.

If a transfer option is to be pursued by NCC, approaching Kāinga Ora to discuss options in the first instance would be a logical first step.



PwC

1 Project review - previous work key outcomes

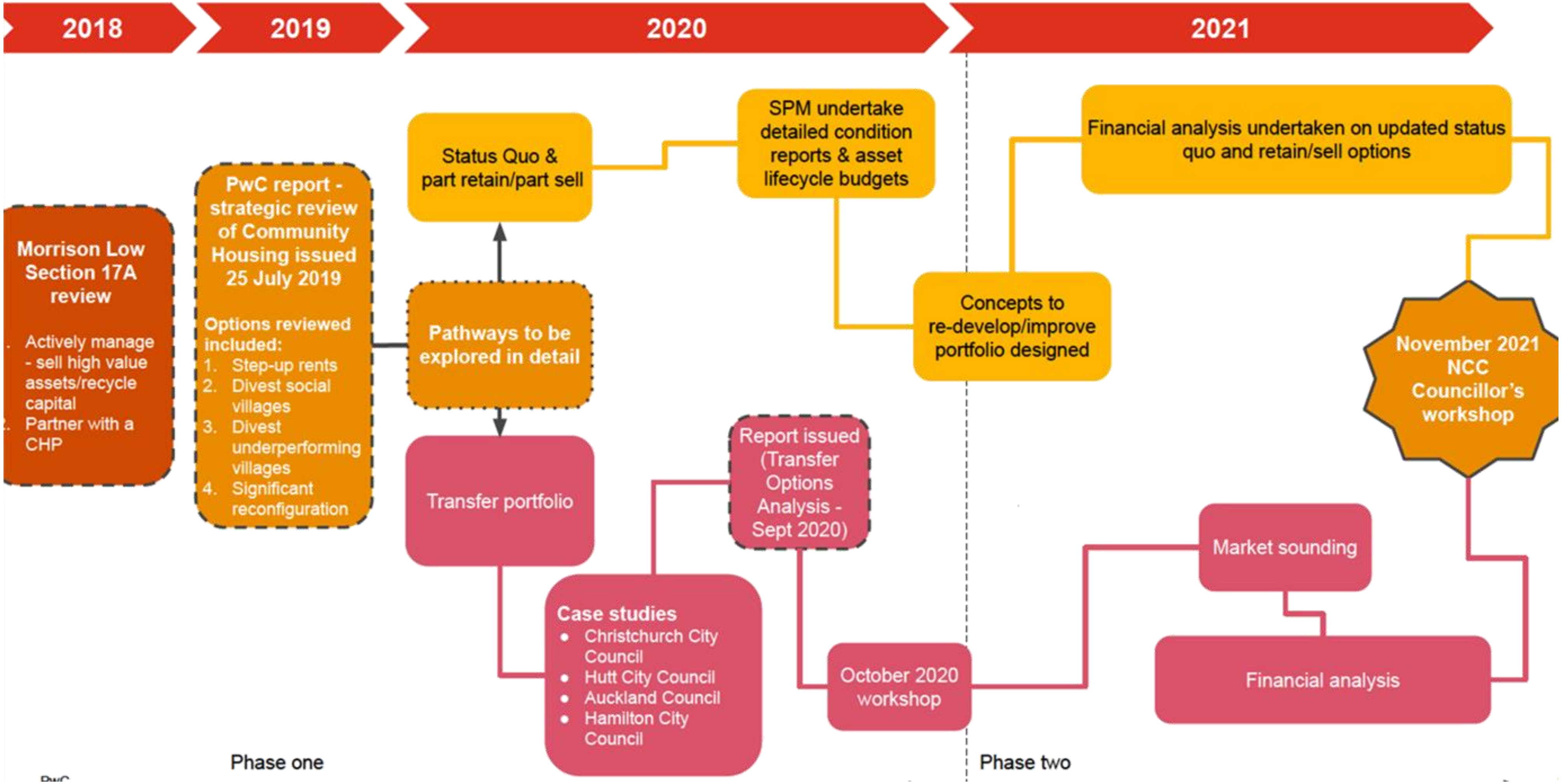
Project progression since 2018

Project Overview

This page presents an overview of the work undertaken by PwC (following the Section 17A review of NCC's Community Housing portfolio undertaken by Morrison Low in 2018) and subsequent PwC July 2019 strategic review which sought to identify pathways to achieve financial sustainability.

Phase two work

Phase two work compromised the development and evaluation of the two main pathways identified in the 2019 report; retain (either as status quo or part retain/part sell) vs transfer of the housing portfolio. This report focuses on our Phase two work,



Key outcomes of October 2020 workshop

We summarise below the evaluation criteria the NCC Councillors worked through at the October 2020 'Transfer Options' workshop when comparing the differing transfer options to agree the preferred transfer option to be evaluated in detail against the Status Quo and part retain/part sell options.

The general consensus was that the **sale or lease of property stock to a CHP was the preferred transfer option to evaluate in detail** with two key requirements that it must be Retirement housing in perpetuity; a first right of refusal if the acquirer sold the property.

Achieving City and Community Goals

- Improve village amenity and site optimisation
- Contribute to Council Strategy, the district plan, long term plan and the HPUDS

Quality Fit for Purpose Housing

- Increased social housing provision
- Increased housing stock in the city

Protecting Tenants' Interests

- Tenancy on the same or better conditions
- Increased access to wrap-around serviceS

Sustainable Financial Outlook

- No ongoing liability for Council
- No ratepayer burden
- Assets are financially self-sufficient, including maintenance and regeneration

Limited Complexity

- Clean transaction with single CHP
- No decanting or tenant impact
- Exit from assets with Council exposure removed
- Limited exposure to market/commercial risk

NCC Ability to Replicate

- Additional resource and investment required
- Comparable portfolio scale
- Comparable Council expertise and capacity

PwC

Key outcomes of October 2020 workshop cont.

The October 2020 'Transfer Options' workshop with NCC Councillors involved reviewing PwC's work associated with identifying and analysing alternative transfer options adopted by other New Zealand councils in relation to their housing portfolios. Set out below are the key observations in context to NCC.

The options reviewed included:

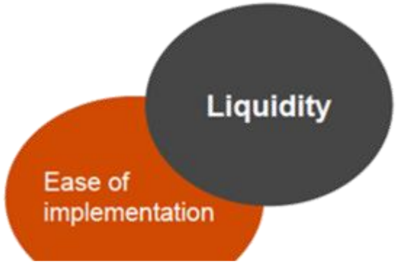
- Formation of a Trust partnership with a CHP - Lease - Christchurch City Counci
- Formation of a CCO - Hutt City Council
- Formation of a Limited Partnership with a CHP - Peppercorn Lease - Auckland
- Sale to a CHP - Hamilton City Council

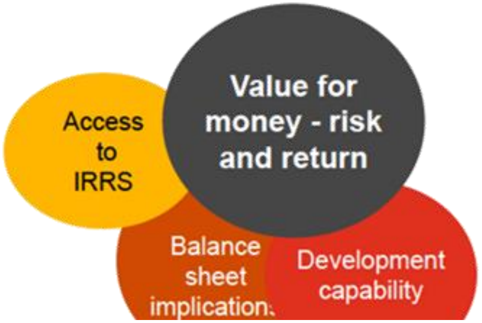
Observations

- Sale to private market investors has low alignment with NCC's evaluation criteria;
- CHP status and access to Crown funding streams (IRRS and Operating supplements) are **critical** for developing a sustainable commercial model that can grow social housing stock and renew the portfolio without creating a burden for ratepayers;
- Transfer to a CHP (combined with contractual covenants) can protect existing communities and tenant rights;
- CHPs generally have a primary social focus with broader networks to social service and community-based organisations enabling better social outcomes;
- Scale of portfolio and in-house capability are major drivers for creation of new CHP structures (versus transfer to existing CHP);
- The leasing model does not generally transfer asset risk/forecast liabilities (costs) of the housing portfolio, it does not release capital and it requires performance monitoring and governance resources;
- Across all delivery models where Council retains an interest, demand for specialised human capital must be considered; and
- Kāinga Ora has emerged as the major player in the public housing sector. They may present an alternative to the CHP sector.

NCC context

- Small/mid-sized and ageing portfolio;
- Requires significant capital investment ~$80m over the next 25 years (SPM forecast);
- The size and capability of NCC's current in-house property and tenancy team significantly limits the ability to actively manage and grow/renew the portfolio;
- In this context, the portfolio transfer option, by way of an asset sale to an established CHP, as demonstrated by Hamilton City Council, has good potential to align with NCC's evaluation criteria;
- This transfer option, structured correctly, has potential to:
  - provide secure and affordable tenure for Council housing occupants;
  - improve financial outcomes for ratepayers;
  - potentially deliver a higher quality and broader service;
  - minimise the complexity of the process; and
  - enable growth in the volume and quality of housing stock within the portfolio through access to Crown subsidies.





PwC

2 Status Quo

Methodology, approach and assumptions

A revised version of the analysis undertaken in 2019 following a detailed asset condition report on the assets

Overview

Under the Status Quo, our core evaluation assumptions were as follows:

- All Social and Retirement villages remain within the portfolio and NCC continues to operate the portfolio in the same way;
- Rental subsidies and rent setting policy remain unchanged. No additional income streams are added;
- Rents for both Retirement and Social villages grow at a rate of 3% per annum (at the upper end of RBNZ inflation target)*;
- Local and regional rates charges against the villages are included; and
- Direct and overhead costs are derived from the 2021-2031 LTP (except for CAPEX - explained later on this page) and we have applied varying levels of cost inflation to these based on index data.

Our approach

As in our July 2019 report, our analysis has focused on the 'Net cashflow position' (Net operating income after R&M and after planned CAPEX) of each village and the portfolio as a whole.

Net cashflow position is a performance measure that removes non-cash expenses (depreciation) to understand the cash outflows associated with asset renewals across the portfolio. It represents the cash surpluses/(deficits) generated by the portfolio, once operational costs and asset renewals are considered.

The ultimate test of sustainability is the cumulative net position of the portfolio in the long run. The portfolio is able to sustain small losses in the short term, as Council can support the portfolio through rates - but to be sustainable in the long term, there must be cash surpluses to offset any cash deficits.

To better understand the condition of the portfolio, SPM Assets completed a detailed condition assessment of all 377 units in the portfolio. This provided unit-by-unit CAPEX forecasts over a period of 25 years (2021 to 2046). In our experience this data only has regard to materials and labour costs and excludes decanting and other associated costs to implement.

Assumptions

We assumed an opening cash balance of zero as there was no opening cash balance in the LTP provided by NCC. Therefore, we are only considering the cashflow effects of those activities included in our forecast.

Net cashflow figures presented in this report (unless explicitly stated otherwise) exclude depreciation and interest charges. By doing so, figures only relate to cash expenses and exclude the financing effects of loans that have been taken out in the past.

When considering the Status Quo, we used figures from the 2021-2031 LTP. This captures all revenues and costs associated with NCC's housing portfolio.

However, we made two key adjustments between the figures in the LTP and the figures used in our financial model that informs forecast cashflows:

- Revenue - instead of using LTP forecast revenues, we modelled revenue ourselves. To forecast revenue in the future, we took actual rates (accurate as of April 2021) charged to different types of tenants and multiplied them by the number of units at each village.
- CAPEX - SPM's outputs were used as forecast CAPEX spend instead of the forecast CAPEX in the LTP. The LTP forecast CAPEX spend is lower than SPM's and based on our experience of Council's historical tendency to underinvest in the portfolio we have relied on SPM's forecast CAPEX as a more realistic level of investment that would be required for NCC to maintain its portfolio over the next 25 years.

*We made a key assumption that NZ Superannuation rates increase by a rate of 3% annually and therefore, policy rents increase at 3% annually. As inflation targets were 1 - 3%, this assumption maintains stability in the model, as the rate of policy rental increases should be similar to increases in expenses.

Status Quo analysis

Revenue analysis

Since PwC's 2019 report, NCC changed the rent setting policy to accommodate tenant 'affordability' recognising the two key tenant cohorts. NCC's current rental policy is:

- Retirement - 30% of net NZ Superannuation (adjusted every July).
- Social - 92% of market rent (to a maximum of 30% of household income).

NCC's policy change resulted in some tenant's rental increasing and some decreasing, and the overall net additional cashflow was insufficient to offset the increased costs in the 2021-2031 LTP (albeit it did increase income from rents overall). The net cashflow position of the portfolio is, on average, worse today than it was in 2019 (as shown in the following graph).

As is the case with many other councils in New Zealand with rental policies set to a percentage of market rent, the social housing policy rent is not currently being met because rents are generally aligned to the tenant's income and ability to pay. Therefore rents have fallen substantially below those policy targets. Within the first years of our forecast, our model estimated that NCC's portfolio achieves on average, circa 43% of forecast market rents (as shown in the adjacent tables).

R&M and CAPEX analysis

To better understand the physical status of the portfolio, in 2019 NCC commissioned SPM Assets to complete a detailed condition assessment of the entire portfolio. All 377 units in the portfolio were inspected by SPM and this assessment was used to generate a programme of works from 2020 to 2046.

The programme of works indicated that the portfolio required significantly more investment in R&M and CAPEX in the immediate future to maintain safe and healthy homes for tenants. This assessment informed the 2021-2031 LTP, where the amount allocated to R&M and CAPEX was significantly increased compared to the 2018-2028 LTP.

SPM's work provided an independent expert estimate of the cost of retaining the portfolio in the long term. If NCC wanted to maintain an acceptable level of accommodation for tenants, they would need to invest heavily in the portfolio.

Understanding the true cost to maintain the portfolio is key for NCC and stakeholders when considering the future options for the portfolio.

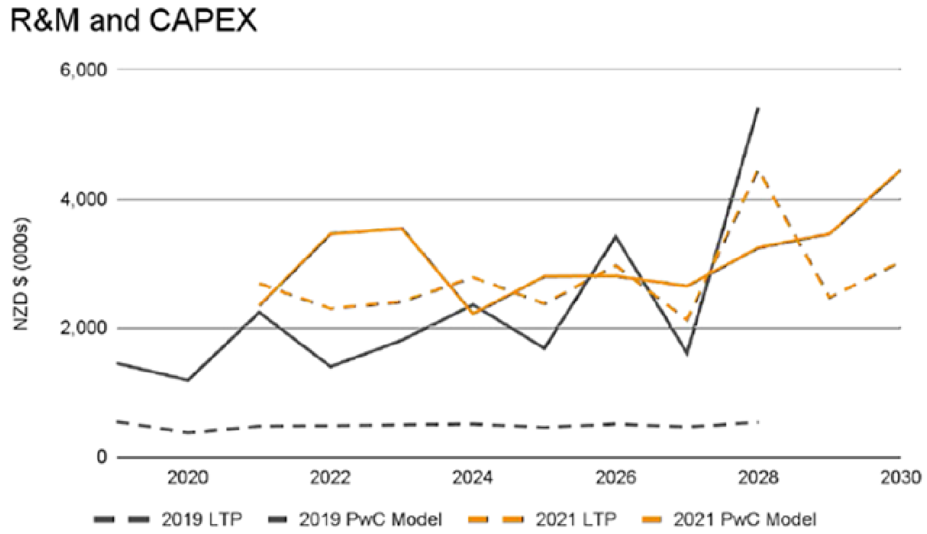
The adjacent graph shows LTP and modelled figures for R&M and SPM figures for CAPEX as in 2019 and in 2021, respectively.

Per unit rent per annum basis

	2021	2022	2023	2024	2025
Average policy rent	$6,694	$6,946	$7,154	$7,389	$7,590
Market rent	$15,520	$15,985	$16,465	$16,959	$17,467
Policy vs market	43%	43%	43%	44%	43%

Portfolio rent per annum

	2021	2022	2023	2024	2025
Average policy rent	$2,523,665	$2,618,639	$2,697,188	$2,785,700	$2,861,427
Market rent	$5,850,862	$6,026,388	$6,207,180	$6,393,395	$6,585,197
Policy vs market	43%	43%	43%	44%	43%



Status Quo analysis cont.

Over the period to 2046 the annualised cost to the ratepayer to fund the shortfall will be circa $2.2m (excluding financing)

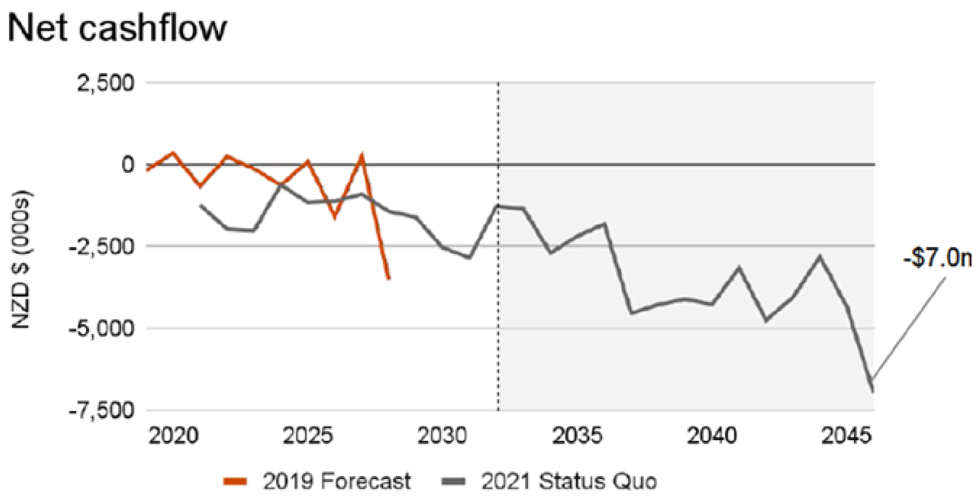
2019 Status Quo forecast cashflows vs revised

During our initial 2018-2019 engagement with NCC, we analysed the forecast cashflows of the portfolio using the 2018-2028 LTP. This forecast estimated nominal accumulated cash shortfall of circa $5.2m to 2028. Relative to the 2019 forecast, the portfolio is now (as a result of a better understanding of deferred maintenance and CAPEX) forecast to run at a larger cash deficit - **a predicted nominal accumulated cash shortfall of circa $10.5m by 2028 increasing to $70.0m by 2046** (refer table below).

The adjacent chart compares the 2019 net cashflow forecasts to the revised forecasts of this report. The 'jagged' cashflows are due to lumpy R&M and CAPEX - other costs such as rates, insurance and overhead expenses remain relatively constant.

Forecast cash outflows are on a steady downward trend, as the amount of capital required to maintain the aging portfolio increases and the Council's current rent setting policy, aimed to maintain 'affordable' housing, limits its ability to charge market rents. **The largest cash deficit in a year is in 2046, where the cashflow shortfall is expected to be circa -$7.0m.**

This year, this deficit has been covered by NCC through raising debt, which NCC confirms is not sustainable in the long term. Ratepayers will eventually have to fund the deficit from the housing portfolio, and the cost will be further increased by the interest that has been incurred on the aforementioned debt. Over the period to 2046 we have estimated the **annualised cost to the ratepayer to fund the shortfall will be circa $2.2m** (excluding financing).



NZD $ (000s)	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034	2035	2036	2037	2038	2039	2040	2041	2042	2043	2044	2045	2046
Retirement Rental Income	1,949	2,023	2,083	2,152	2,210	2,276	2,345	2,422	2,487	2,562	2,639	2,726	2,800	2,884	2,970	3,068	3,151	3,246	3,343	3,453	3,547	3,653	3,763	3,886	3,992	4,111
Social Rental Income	573	594	612	632	649	669	689	711	731	753	775	801	822	847	873	901	926	953	982	1,014	1,042	1,073	1,105	1,142	1,173	1,208
Misc. Income	2	2	2	2	2	2	2	2	2	2	2	2	3	3	3	3	3	3	3	3	3	3	3	3	3	4
Total Revenue	2,524	2,619	2,697	2,786	2,861	2,947	3,036	3,135	3,221	3,317	3,417	3,529	3,625	3,733	3,845	3,972	4,080	4,202	4,328	4,470	4,592	4,729	4,871	5,031	5,168	5,323
(Direct Costs)	-1,927	-1,980	-2,033	-2,084	-2,137	-2,192	-2,250	-2,310	-2,372	-2,435	-2,474	-2,538	-2,604	-2,672	-2,742	-2,813	-2,886	-2,961	-3,038	-3,117	-3,198	-3,281	-3,367	-3,454	-3,544	-3,636
(Overhead Costs)	-800	-492	-516	-522	-536	-558	-568	-583	-607	-614	-624	-641	-657	-674	-692	-710	-728	-747	-767	-787	-807	-828	-849	-872	-894	-917
EBITDA	-203	147	148	180	188	197	217	242	241	268	318	350	363	387	412	449	465	494	523	566	586	620	655	705	730	769
Total Capital Expenditures	-1,037	-2,110	-2,159	-803	-1,346	-1,317	-1,120	-1,674	-1,849	-2,798	-3,162	-1,625	-1,712	-3,087	-2,593	-2,264	-4,998	-4,766	-4,624	-4,833	-3,738	-5,367	-4,702	-3,517	-5,067	-7,737
Net Cashflow	-1,240	-1,963	-2,011	-623	-1,158	-1,120	-902	-1,432	-1,608	-2,530	-2,844	-1,276	-1,349	-2,700	-2,181	-1,815	-4,532	-4,273	-4,101	-4,266	-3,151	-4,747	-4,047	-2,811	-4,338	-6,967
Opening Cash Balance	-	-1,240	-3,203	-5,214	-5,837	-6,995	-8,116	-9,018	-10,450	-12,057	-14,588	-17,432	-18,708	-20,056	-22,757	-24,938	-26,753	-31,285	-35,558	-39,659	-43,925	-47,076	-51,823	-55,871	-58,682	-63,020
Free Cashflow from Existing Portfolio	-1,240	-1,963	-2,011	-623	-1,158	-1,120	-902	-1,432	-1,608	-2,530	-2,844	-1,276	-1,349	-2,700	-2,181	-1,815	-4,532	-4,273	-4,101	-4,266	-3,151	-4,747	-4,047	-2,811	-4,338	-6,967
Closing Cash Balance	-1,240	-3,203	-5,214	-5,837	-6,995	-8,116	-9,018	-10,450	-12,057	-14,588	-17,432	-18,708	-20,056	-22,757	-24,938	-26,753	-31,285	-35,558	-39,659	-43,925	-47,076	-51,823	-55,871	-58,682	-63,020	-69,987

Status Quo analysis cont.

Status Quo maintains status quo for the current tenants at the cost to ratepayers and does not contribute to the growing future community housing needs

Achieving key outcomes

Maintaining the Status Quo does not achieve 'City and Community Goals' of improved amenity and site optimisation as the dated units remain, albeit with some slight improvement through increased CAPEX spend. Recent changes to the RTA (Residential Tenancies Act) now present additional challenges in NCC's ability to maintain it's Community Goals by constraining its ability to manage and ensure the housing remains occupied by eligible tenants. Changes to the RTA prevent the ability to terminate a tenancy on the grounds that a tenant no longer meets the income or assets thresholds. Whilst CHPs and Kāinga Ora have been granted exemptions to this restriction, local Councils are classified as 'private owners' and do not therefore enjoy this exemption.

Without external funding from third parties or increasing ratepayer contributions (or debt) there is no ability to increase community housing stock or redevelop the existing stock to meet changing tenant demands.

Existing tenants' interests are protected as their tenancies remain. However, the current level of services provided will remain i.e limited to basic tenancy management services which are no longer comparable to the increasing 'wrap-around' services provided by Kāinga Ora and CHPs.

As mentioned, the Status Quo is not financially sustainable and the financial position of the portfolio steadily worsens across the forecast period.

Whilst there is no financial impact on the tenant, there is an increasing financial burden to the ratepayer with an indicative annualised cost of circa $2.2m p.a. to be met. That is, the ratepayers need to invest circa $2.2m (in 2021 dollars) every year for the next 25 years to meet the cash shortfall (to break-even) generated by the portfolio over the corresponding years. This financial burden will be further emphasised with the reduction in Council rates revenue due to the proposed Three Waters reform; the proportion of rating revenue being applied to subsidised housing will increase.

The Status Quo simply maintains status quo for the current tenants at the cost to ratepayers and does not contribute to the growing future community housing needs of the wider community.

	Status Quo
Achieving City and Community Goals	✗
Quality Fit for Purpose Housing	✗
Protecting Tenants' Interests	✓
Sustainable Financial Outlook	✗
Tenant financial impact	—
Ratepayer financial impact	↓ Annualised ratepayer contribution of circa ~$2.2m to fund Status Quo

PwC

Status Quo sensitivity analysis

Financial sustainability is achievable with retirement policy rent set @ ~78% market rent equating to ~49% of a retiree's income

Affordable vs using a blended rate subsidised rents

NCC's current rent setting policy, aimed to maintain 'affordable' housing, means it receives only 30% of the net NZ Superannuation allowance from retirement tenants and a maximum of 30% of household net income from social tenants. There are a small number of tenants who pay slightly more than this as their income and/or assets are over the threshold.

NCC's net income threshold set for social tenants is currently $762 p/w opposed to the NZ Superannuation rate for a single occupant of $437 p/w (2021). We have assumed that these are the maximum incomes for eligible NCC tenants and accordingly rents are set at 30% of these levels.

To increase profitability and make the portfolio sustainable in the future, NCC could switch from an 'affordable' rental policy to a 'subsidised' policy, whereby NCC would still provide accomodation at a discounted rate but linked to a set percentage of the market rate. This could enable the council to meet its R&M and CAPEX obligations, and potentially increase the level of service it provides tenants (depending on the percentage of market rent set).

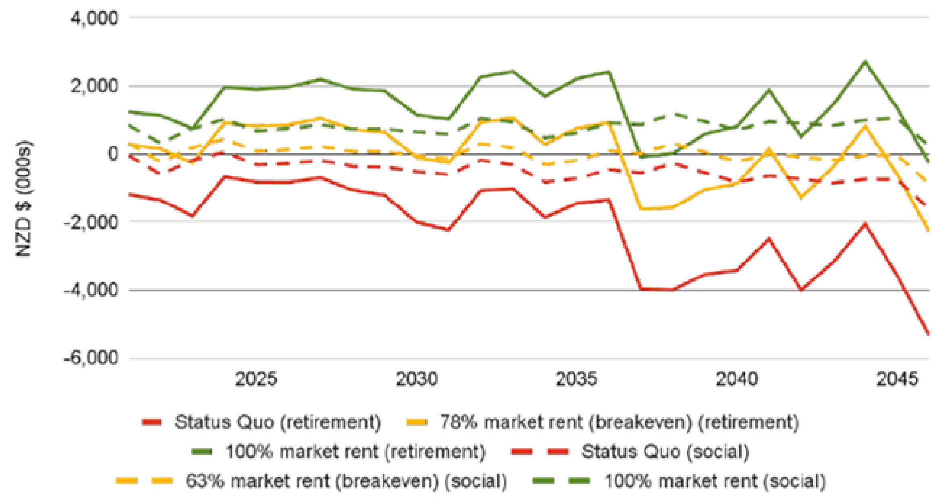
The adjacent tables and graphs demonstrate the impact on the cashflow relative to the percentage of market rent received (for both retirement and social villages). We have estimated that retirement policy rent would need to be set at around **78% of market rent over the next 25 years to break even**. This would equate to 49% of an individual retirement tenant's income. For a social tenant, we have estimated the policy rent would need to be circa 63% of market rent over the next 25 years. This would equate to 32% of an individual social tenant's income.

While this would be beneficial to NCC and its ratepayers, an increase of this level of rent is unlikely to be affordable to current retirement tenants (typically rent of circa ⅓ of income is considered affordable), but it could be affordable to other retirees who sit at the lower end of the private rental market. Under a 'subsidised' rental policy, NCC could still provide housing to its retired constituents, however, it may not be providing it to those with the greatest need.

An issue with setting policy rent as a percentage of market rent is that large year-on-year increases in market rent can make policy rent unaffordable. We note that rents rose 15.5% on average in the year to June 2021 - an increase that would likely be unaffordable for most tenants on fixed incomes.

While rent increases may potentially be unpopular with current tenants, the opportunity for the housing to remain with Council may outweigh these concerns, while also not impacting on ratepayers.

Rent setting impact on Status Quo cashflows



Rental policy % of market rent	% of 2021 super single rate ($437 p/w)	% of individual social tenant income threshold ($762 p/w)	Annualised net cashflows	Cumulative nominal position after 25 years
Retirement (market rent ~$276 p/w)				
Current - 45%	28%	n.a.	-$2.17m	-$56.40m
Breakeven - 78%	49%	n.a.	$0.00m	$0.00m
100%	63%	n.a.	$1.42m	$37.01m
Social (market rent ~$387 p/w)				
Current - 39%	n.a.	20%	-$0.52m	-$13.59m
Breakeven - 63%	n.a.	32%	$0.00m	$0.00m
100%	n.a.	51%	$0.79m	$20.52m

3 Part Retain/Part Sell option

Methodology, approach and assumptions

Overview

PwC's 2019 strategic review analysed several scenarios / pathways to achieve financial sustainability. Of these pathways, 'Scenario 4a' was, although complex, identified as the most likely to support financial sustainability and it was this scenario that was agreed to be compared against the Status Quo option and Transfer option.
The part retain/part sell option assumes:

- The three Social villages (underperforming assets) are divested and the sale proceeds reinvested;
- All Retirement villages remain within the portfolio and NCC continues to operate the portfolio in the same way;
- Rental subsidies and rent setting policy remain unchanged. No additional income streams are added;
- Rents for Retirement villages grow at a rate of 3% per annum (at the upper end of RBNZ inflation target);
- Greenmeadows East Village's vacant land (~circa 9,300m^2) is intensified with additional Retirement housing; and
- The existing four houses on Hastings/Munroe site are demolished and redeveloped with new units for market rent to subsidise the Community Housing portfolio.

Our approach

To develop this concept into a detailed scenario for financial analysis we worked with the following parties:

- NCC urban planners to establish the likely permissible site coverage, heights, housing typology, infrastructure requirements etc to provide guidance to the design architects and review and test concepts presented.
- Young + Richards (architects) - selected via a Request for Proposal (RFP) process to provide high level concepts for both sites. Young + Richards has experience in the community housing sector, working with Kāinga Ora and other Councils to design developments of similar size and typology. Concepts from Young + Richards were completed with the intent of providing low-cost social rental units that would be able to accommodate senior and some disabled tenants, applying 'Good Quality Social Housing' practices consistent with Kāinga Ora's requirements
- Rider Levett Bucknall (RLB) (quantity surveyors) who provided estimates as at February 2021 inclusive of all development costs including fees, housing, landscaping, demolition, utility provision and connection, landscaping, roadways and vehicle crossings. Housing was assessed at Good Quality Social Housing with all amenities including heating, basic appliances and window treatments. Fencing has been allowed to all separate properties. GST, land purchase and potential Resource Consent hearing costs were excluded. RLB's cost estimates include 7.5% contingency and 16% cost escalation to 2026.

Following consultation with NCC urban planners, the concepts from Young + Richards that were adopted included (as shown on page 20):

- Greenmeadows East (net increase 38 units) - 12 x 1-bed units, 8 x 2-bed terraced units, 8 x 1-bed walk-up units, 10 x 2-bed walk-up units, primarily for retirees.
- Hastings/Munroe (net increase 7 units) - demolition of 4 units and creation of 11 new units - 7 x 2-bed terraced units, 4 x 3-bed terraced units.

Assumptions

We made the following assumptions (among others) for our cashflow model:

- Divestment of the three Social villages will occur first to assist funding the development works;
- Sale prices for the divested villages are established on a discounted cash flow (DCF) basis, assuming a CHP purchases these sites with sitting tenants and policy rent switches to market rent (via IRRS) at a rate of 15% annually (current turnover rate);
- Development works will commence at Greenmedows East to accommodate eligible tenants. Construction will be phased enabling some tenants to move in while remaining units are completed. Construction costs on the Redeveloped villages will be realised in a linear fashion;
- Commencement of works to Hastings/Munroe is dependent upon existing tenants relocating to new units in Greenmeadows East or other retirement villages (this is highly likely given current tenant turnover);
- Forecast future CAPEX spend on the Redeveloped villages is based on useful lifespans and costs of components and establishing a 'sinking fund'; and
- CAPEX works are allocated to occur predominantly over the warmer months of the year in Quarters 2 and 3 (from 1 October to 31 March).

Part retain/part sell potential timeline

Timeline (as at March 2021)

We adopted the following timeline in modelling the cashflows associated with part retain/part sell. The assumed date of disposal of Social villages is 1 July 2022 (the start of FY23) and both developments will be completed by 1 April 2027.

This timeline was developed following the guidance of RLB, in March 2021, who have estimated the length of each project and overall cost of the development process. The overall timelines will be dependent upon start date.

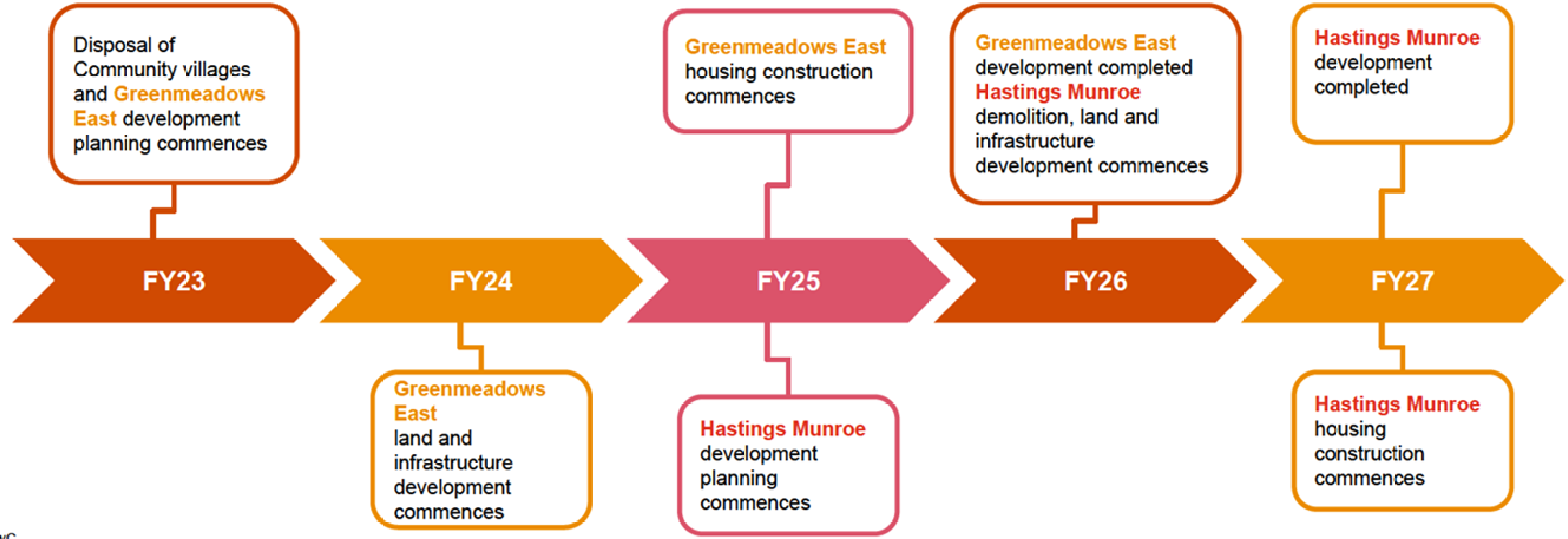
Key assumptions are as follows:

- 16% cost escalation to 2026;
- 7.5% contingency; and
- Zero cost for land purchase and resource consents.

See Appendix 2 for RLB's estimates.

Indicative construction timeframes (as advised by Quantity Surveyors, RLB)

Greenmeadows East		Hastings/Munroe	
Development planning	10 - 12 months	Development planning	6 - 9 months
Land & infrastructure development	8 - 10 months	Land & infrastructure development	4 - 6 months
Housing and construction	16 - 18 months	Housing and construction	8 - 10 months
Total	34 - 40 months	Total	18 - 25 months
Estimated cost (incl. contingency and escalation)	**$18.64 million (excl. GST)**	Estimated cost (incl. contingency and escalation)	**$6.32 million (excl. GST)**



Part retain/part sell redevelopment opportunities

Greenmeadows East - concept only

Hastings Munroe - concept only

Part retain/part sell cashflows

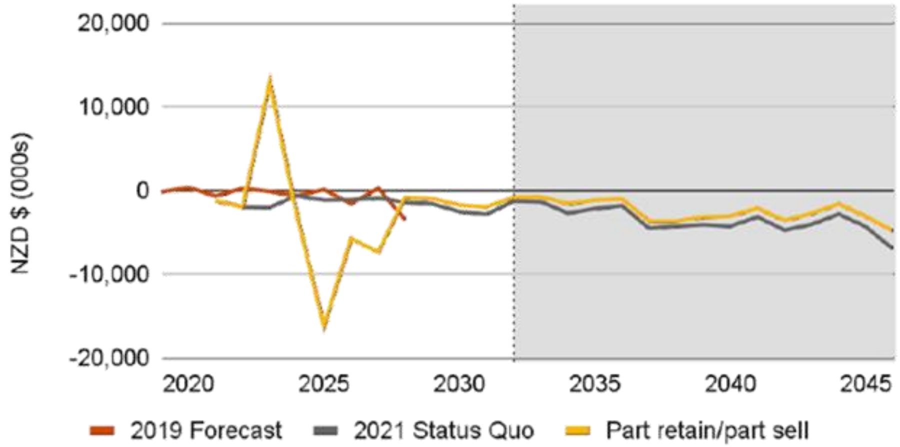
Part retain/part sell only marginally improves the cashflow position after 2028 - the cashflow injection from sale proceeds and rent from increased units falls short of redevelopment costs

Retain/Sell forecast cashflows

Under the part retain/part sell scenario, we assumed that the three Social villages (Carlyle, Nelson and Wellesley) will be divested at the beginning of FY23 with the sale proceeds contributing to the redevelopment costs for Greenmeadows East and Hastings/Munroe. While the current market valuation of these three villages is circa $16.2m (as at 2020), this market valuation represents highest and best use (e.g. capitalised 'market' rent, or redevelopment value). On a DCF basis relative to actual contract, the transaction value would be materially lower than the 'market' value assuming a CHP purchases these sites with sitting tenants and policy rent switching to market rent (via IRRS) at a rate of 15% annually (current turnover rate); likely close to 40% to 70% of unencumbered market value. Consequently, as illustrated in the adjacent graph, the sale proceeds will not cover the cost of the additional units.

The cashflows of the part retain/part sell scenario are marginally improved relative to the Status Quo after 2028 primarily due to the net increase of new units and the ability to lease the 11 units at the redeveloped Hastings/Munroe village at market rates. However, despite improving the later year cashflow position of the portfolio, the part retain/part sell option will not achieve breakeven with **a predicted nominal accumulated cash shortfall of circa $23.3m by 2028 increasing to $64.9m by 2046** (refer table below).

Net cashflow



Over the period out to 2046 we have estimated the **annualised cost to the ratepayer to fund the shortfall will be circa $2.3m** (excluding financing).

NZD $ (000s)	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033
Retirement Rental Income	1,949	2,023	2,083	2,152	2,196	2,247	2,315	2,391	2,456	2,529	2,605	2,691	2,764
Social Rental Income	573	594	161	9	9	9	9	10	10	10	11	11	11
Misc. Income	2	2	2	2	2	2	2	2	2	2	2	2	2
Total Revenue	2,524	2,619	2,246	2,162	2,207	2,259	2,326	2,403	2,468	2,542	2,618	2,704	2,778
(Direct Costs)	-1,927	-1,980	-1,714	-1,648	-1,642	-1,635	-1,679	-1,723	-1,769	-1,816	-1,846	-1,894	-1,943
(Overhead Costs)	-800	-492	-418	-389	-397	-411	-418	-429	-447	-452	-459	-471	-484
EBITDA	-203	147	114	125	168	212	230	251	251	274	313	339	351
Total Capital Expenditures	-1,037	-2,110	-2,159	-803	-964	-975	-854	-1,233	-1,388	-2,193	-2,443	-1,322	-1,279
Net Cashflow	-1,240	-1,963	-2,045	-678	-796	-763	-624	-982	-1,137	-1,920	-2,129	-983	-928
Opening Cash Balance	-	-1,240	-3,203	9,692	6,738	-9,444	-15,179	-22,535	-23,336	-24,314	-26,073	-28,041	-28,853
Free Cashflow from Existing Portfolio	-1,240	-1,963	-2,045	-678	-796	-763	-624	-982	-1,137	-1,920	-2,129	-983	-928
Village Disposal Proceeds	-	-	15,044	-	-	-	-	-	-	-	-	-	-
(Village Redevelopments)	-	-	-104	-2,276	-15,370	-4,943	-6,773	-	-	-	-	-	-
Incremental FCF from Village Redevelopments	-	-	-	-	-16	-30	41	182	159	161	162	170	176
Closing Cash Balance	-1,240	-3,203	9,692	6,738	-9,444	-15,179	-22,535	-23,336	-24,314	-26,073	-28,041	-28,853	-29,605

NZD $ (000s)	2034	2035	2036	2037	2038	2039	2040	2041	2042	2043	2044	2045	2046
Retirement Rental Income	2,847	2,932	3,029	3,111	3,204	3,300	3,409	3,501	3,606	3,715	3,836	3,941	4,059
Social Rental Income	12	12	12	13	13	13	14	14	15	15	16	16	17
Misc. Income	3	3	3	3	3	3	3	3	3	3	3	3	3
Total Revenue	2,861	2,947	3,044	3,126	3,220	3,317	3,425	3,519	3,624	3,733	3,855	3,960	4,079
(Direct Costs)	-1,993	-2,045	-2,099	-2,153	-2,209	-2,266	-2,325	-2,386	-2,448	-2,512	-2,577	-2,644	-2,713
(Overhead Costs)	-496	-509	-522	-536	-550	-564	-579	-594	-609	-625	-641	-658	-675
EBITDA	371	392	423	437	461	486	521	539	567	596	637	658	691
Total Capital Expenditures	-2,132	-1,742	-1,668	-4,289	-4,334	-3,891	-3,801	-2,918	-4,400	-3,610	-2,529	-4,028	-5,835
Net Cashflow	-1,761	-1,350	-1,245	-3,852	-3,872	-3,406	-3,280	-2,379	-3,833	-3,014	-1,892	-3,369	-5,143
Opening Cash Balance	-29,605	-31,183	-32,341	-33,385	-37,028	-40,684	-43,864	-46,906	-49,040	-52,617	-55,365	-56,977	-60,057
Free Cashflow from Existing Portfolio	-1,761	-1,350	-1,245	-3,852	-3,872	-3,406	-3,280	-2,379	-3,833	-3,014	-1,892	-3,369	-5,143
Village Disposal Proceeds	-	-	-	-	-	-	-	-	-	-	-	-	-
(Village Redevelopments)	-	-	-	-	-	-	-	-	-	-	-	-	-
Incremental FCF from Village Redevelopments	183	191	202	208	217	226	238	245	256	266	280	289	301
Closing Cash Balance	-31,183	-32,341	-33,385	-37,028	-40,684	-43,864	-46,906	-49,040	-52,617	-55,365	-56,977	-60,057	-64,900

Part retain/part sell cashflows

Part retain/part sell marginally improves housing stock and community goals but at a greater ongoing cost to ratepayers

Achieving key outcomes

Part retain/part sell partially achieves the key outcomes of "Achieving City and Community Goals" by increasing some village amenity, site optimisation, "Quality Fit for Purpose Housing" and by increasing the volume of housing stock in the city. However, as with the Status Quo, recent changes to the RTA will present additional challenges in NCC's ability to maintain its Community Goals by constraining its ability to manage and ensure the housing remains occupied by eligible tenants. As with the Status Quo option, changes to the RTA will prevent the ability to terminate a tenancy on the grounds that an occupier no longer meets the income or assets thresholds.

Retirement village tenants interests are protected as their tenancies remain in place. This would potentially extend to the tenants within the Social villages, dependent upon the sale contract conditions albeit reflective of the sale proceeds received. As with the Status Quo option the current level of services provided will remain i.e limited to basic tenancy management services which are no longer comparable to the increasing 'wrap-around' services provided by Kāinga Ora and CHPs.

Like Status Quo, the part retain/part sell option is not financially sustainable. Even after divestment of underperforming assets and building new units, the portfolio still returns a negative cashflow each year.

There is no financial impact on existing Retirement village tenants with the financial impact on the Social village tenants dependent upon the sale contract conditions.

Despite generating greater cashflows than Status Quo, ratepayers would face a larger annualised contribution of indicatively ~$2.3m due to the requirement to meet the shortfall between sale proceeds of the underperforming assets and the redevelopment and intensification costs. As with the Status Quo option, this financial burden will be further emphasised with the reduction in Council rates revenue due to the proposed Three Waters reform; the proportion of rates dollars going to fund subsidised housing will increase.

In addition to these outcomes, the part retain/part sell option introduces a number of variables, not limited to: scarcity and cost of building supplies, availability of contractors and cost escalation all increasing the complexity of implementation.

	Part retain/part sell
Achieving City and Community Goals	✓ / ✗
Quality Fit for Purpose Housing	✓ / ✗
Protecting Tenants' Interests	✓
Sustainable Financial Outlook	✗
Tenant financial impact	—
Ratepayer financial impact	↓ Annualised ratepayer contribution of circa ~$2.3m to fund Part retain/part sell

PwC

Part retain/part sell sensitivity analysis

Financial sustainability is achievable with policy rent set @ ~81% market rent equating to ~52% of a retiree's income

Affordable vs subsidised rents

As with the Status Quo option, to increase profitability and make the portfolio sustainable in the future, NCC could switch from an 'affordable' rental policy to a 'subsidised' policy, whereby NCC would still provide accomodation at a discounted rate but link rent to a set percentage of the market rent. This could enable the council to recover its R&M and CAPEX obligations, and potentially increase the level of service it provides tenants,depending on the percentage of market rent set.

As opposed to the Status Quo option, under this scenario the social villages are divested and the occupants will be retirees only. Therefore, the adjacent table and graph demonstrates the impact on the cashflow relative to the percentage of market rent received for the retirement villages only (post 2023). We have estimated that policy rent would need to be set at around **81% of market rent over the next 25 years to break- even**. While this would be beneficial to NCC and its ratepayers, based on the NZ 2021 superannuation single person allowance rate, 81% of market rent would equate to 52% of an individual retirement tenant's income representing an increase of circa 22% to what is currently paid by the individual retirement tenant.

An increase of this level of rent is unlikely to be affordable to current tenants, but it could be affordable to other retirees who sit at the lower end of the private rental market. Under a 'subsidised' rental policy, NCC could still provide housing to its retired constituents, however, it may not be to those with the greatest need.

An issue with setting policy rent as a percentage of market rent is that large year-on-year increases in market rent can make policy rent unaffordable. We note rents rose 15.5% on average in the year to June 2021 - an increase that would likely be unaffordable for some tenants.

While rent increases may potentially be unpopular with current tenants, the opportunity for the housing to remain with Council may outweigh these concerns, while also not impacting on ratepayers.

Rent setting impact on Part retain/part sell cashflows

Retirement villages only

Rental policy % of market rent	% of 2021 super single rate ($437 p/w)	Annualised net cashflows	Cumulative nominal position after 25 years
45%	28%	-$2.71m	-$70.41m
50%	32%	-$2.34m	-$60.75m
60%	38%	-$1.59m	-$41.43m
70%	44%	-$0.85m	-$22.10m
81%	52%	$0.00m	$0.00m
90%	57%	$0.64m	$16.54m
100%	63%	$1.38m	$35.86m

[redacted]

4 Transfer options

Methodology and approach

Overview

The general consensus from the October 2020 Councillor's workshop was that whilst a sale or lease of property stock to a CHP was the preferred transfer option to evaluate in detail, covenants would be required to protect tenants interest and prevent on selling of the assets. The transfer option therefore assumes that any transfer contract would contain covenants that:

- ensure existing tenancies, under the current terms and conditions, remain in place;
- the portfolio can only ever (into perpetuity) be used to provide housing to Retirement or Community tenants; and
- NCC retains the right of first refusal (on the same DCF basis) if the buyer was to sell the portfolio.

Our approach - market sounding

Market soundings were required to understand the market's appetite for the portfolio in its current state with covenants in place and to ascertain likely key commercial terms. In consultation with NCC's Community Strategies team, a shortlist of parties to approach was established, primarily focussed on parties with CHP status to enable access to IRRS. The list consisted of local Iwi, charitable trusts, CHPs and Kāinga Ora - parties who share common goals with NCC in regard to community housing.

These parties included:

[redacted]

An Information Memorandum (IM), comprising the purpose and key facts about the portfolio was created for circulation to interested parties (in strict confidence) (refer Appendix 3) including data on the following:

- number of villages and units;
- forecast gross rent 2021 vs estimate or market rent received;
- forecast annualised R&M;
- forecast capital expenditure over next 10 years;
- age and typology of units;
- annual tenant turnover;
- estimate percentage of tenants eligible for IRRS; and
- potential development opportunities e.g. Retirement village expansion (Greenmeadows East, Hastings/Munroe).

Video calls (in place of face-to-face meetings due to COVID-19) were held with those parties to ascertain in each case:

- their level of interest and ability to purchase the portfolio (all or part);
- the terms under which they would purchase or manage the portfolio;
- how they would value the portfolio;
- experience purchasing other housing portfolios; and
- ethos and purpose.

The results of these calls helped us to group the parties based on their ability and appropriateness to partner with NCC in the transfer of the portfolio.

Market soundings - parties approached & their responses

Local Iwi, charitable trusts, CHPs and Kāinga Ora

Below we have set out the key highlights from our interviews with the various parties contacted.

[redacted] **(registered charity)** - In the process of becoming a CHP. They have been more interested in building their own stock as this provides opportunities for apprenticeships and employment for their whanau. However, they may be interested in purchasing at the 'right price'.

[redacted] **(registered charity)** - The scale of the portfolio is attractive [redacted] In its experience, around 350 units are needed to begin to achieve economies of scale and efficiencies in regard to management. [redacted]

[redacted] **) (registered charity)** - [redacted] would only be interested in providing tenancy management services for a fee (circa 10% - 15% of gross revenue) as they are not in a financial position to purchase. Its expectation is that the R&M and CAPEX costs would remain the responsibility of the Council. [redacted]

[redacted] **(registered charity)** - Favour building new units as they are eligible for operating supplement too. They place a lot of value in the community aspect of the villages - community spaces and halls are key. [redacted] would only be interested in purchasing the portfolio if the price was significantly discounted.

[redacted] **(registered charity)** - Focused on the Wairarapa region. Unlikely to be interested in the purchase of properties. [redacted] would only be interested providing tenancy management services for a fee (circa 10% - 15% of gross revenue).

[redacted] **(registered charity)** - [redacted] Would be interested in a deal if it was 'sensible'.

[redacted] **(registered charity)** - [redacted] Purchases made on condition that tenants were retained and on intrinsic (cashflow) value.

[redacted] **(registered charity)** [redacted] hey would require a one-off specific mechanism to purchase the portfolio - with the right partner.

[redacted] **(registered charity) -** [redacted] Would be interested if there was a link with Hastings District Council as they consider that they have an established relationship there.

Kāinga Ora - Napier is a priority area for Kāinga Ora, but they prefer to acquire land (for development) that is not tenanted. Very interested in the development opportunities [redacted]

[redacted]

CHPs' legislative requirements

The Community Housing website notes that typically CHPs are not-for-profit groups, but CHPs can be for-profit entities. All of the CHPs we approached were not-for-profit groups.

From a practical standpoint, it can be hard for CHPs to make profit and it is likely that any surplus made would be required to fund CHP operations or invested to expand their offering given the needs in communities. Accordingly, there may be limited practical value in operating a CHP ostensibly as a for-profit entity. There are always difficulties from a public perception and political perspective; profiting at the expense of the most vulnerable members of society and/or using central government funding to do so. This may affect their ability to receive grant funding or funding from central government mechanisms as well e.g. operating grants.

In regard to tax considerations associated with CHP income (as a high level observation only - not intended to be tax advice), section CW 42B of the Income Tax Act provides that any amount of income derived by a registered CHP is exempt income. However if a CHP were to use the profit from their community housing activities for the private pecuniary profit of an individual or apply it to something outside of the community housing entity or for non charitable purposes, then the CHP's income would not be exempt under this section. That loss of exemption would likely also exacerbate the practical issues with taking a profit stream from a CHP.

Key findings from CHPs

Focus is to invest in the 'golden triangle' - high growth, high need and fair returns; immediate access to IRRS is unlikely

Elements of interest

CHPs were attracted by the size and tenant profile of the portfolio as this scale supports establishment of a local team and resources.

The tenant profile potentially enables access to Crown funding streams (IRRS) but it was noted that this would take time to achieve as ~90% of the 377 tenancies might be eligible, but CHPs can only access IRRS for new incoming tenants.

The development potential (Greenmeadows East and Hastings/Munroe) was another attractive element of the portfolio as CHPs can potentially secure Operating Supplement funding in addition to IRRS for new supply. It was noted, however, that the real value is in 'net' new supply of units i.e Hastings/Munroe with the demolition of four existing units would create a net new supply of seven.

Elements of concern

The primary source of concern from CHPs is the significant capital investment required for CAPEX and R&M. This would need to be factored into the commercial terms of any transfer. To fully understand the condition of the portfolio, CHPs would need to undertake a robust due diligence process, which can be costly.

Securing funding to purchase and develop may be a challenging with the likely requirement to establish joint venture or access additional competitive 'capital'.

Early consultation with MSD would be essential to ascertain eligiity to access IRRS. Some CHPs fear that existing stock might not meet MSD housing criteria (e.g minimum gross floor area, bedroom sizes and healthy home compliance). Additionally, the time required to transfer the rental profile to market rent via access to IRRS is a concern; understanding tenant turnover would be key.

Other

None of the CHPs preferred a leasing model as the ability to expand and grow the portfolio was seen as key to achieving financial sustainability - preference was for a purchase.

An alternate option to a purchase transfer was the provisions of a management contract under CHP status. Whilst this option would provide increased 'wrap around' tenancy services NCC would retain responsibility for R&M and CAPEX on top of paying 10 - 15% of Gross revenue received to the CHP.

Transfer covenants to protect tenant and community interests are acceptable but will be reflected in the assessment of asset value. CHPs would value this based on a discounted cashflow approach using policy rents (see slide 33).

[redacted]

However - Some CHPs suggested that they would be unlikely to participate in a tender process if Kāinga Ora was a participant - Kāinga Ora with its ability to access IRRS immediately can generally offer better

Kāinga Ora

Key focus areas of Kāinga Ora is 'Additionality' - ability to provide NEW housing supply

Kāinga Ora has emerged as a potential important shareholder in the community housing sector and may present an alternative to the CHP sector as it is the key government entity with the mandate to deliver on social housing.

Focus areas

A key focus area of Kāinga Ora is 'additionality' - the ability to provide additional 'new' housing supply. This is an attempt to address the increasing strains on the public housing sector as more and more people require its services. Opportunities for intensification and redevelopment are therefore sought after by Kāinga Ora.

Napier and the wider East Coast is an area targeted under the latest government Public Housing Plan (2021-2024). Napier has been identified as a location where housing need is urgent due to population growth exceeding new housing development, leading to rising rents and housing shortfall. There are intentions for an additional net supply of 1,287 units from June 2018 to June 2024.

Potential benefits for NCC

The benefits of Kāinga Ora purchasing the portfolio over a CHP is Kāinga Ora's ability to access IRRS immediately (as we understand it), unlike CHPs which can only access IRRS for new incoming tenants.

Immediate access to IRSS will also benefit the NCC's existing eligible tenants (~90%). Generally tenants eligible for and receiving IRRS are only required required to pay 25% of their net incomes or Superannuation payments - currently NCC tenants pay 30%.

[redacted]

Potential benefits for Kāinga Ora

The benefit to Kāinga Ora is that they can achieve 'additionality' at pace. With the Hastings/Munroe and Greenmeadows East concepts already developed (with NCC urban planners involvement) these opportunities could be acted upon immediately.

Nelson Case study (sold to Kāinga Ora)

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

In relation to NCC...

Nelson CC's portfolio was smaller than NCC's, and slightly younger. There was on average, around 15 to 20 years of useful life left in the units upon transfer.

NCC has the benefit of additional land at some sites which would offer the opportunity to achieve 'additionality' [redacted]

Potential cashflows/valuation considerations

Discounted Cashflow valuation approach

All CHPs we engaged with informed us that they would value the portfolio on a discounted cashflow (DCF) basis. A DCF 'discounts' an asset's future cashflows by a discount rate to reflect the opportunity cost of any investment and the time value of money. For example, $1 received five years from now is less valuable than $1 today as you could invest today's dollar and receive interest over the next five years.

We have completed indicative modelling of NCC's forecast cashflows and applied, as a working assumption, a discount rate range of 5.0% to 6.0% to reflect the age and condition of the portfolio. We did receive feedback from the market (CHPs) that these discount rates are potentially high; based on discussion with NCC we have adopted a slightly more conservative discount rate range. Relative to the cashflows of a newer housing portfolio, NCC's cashflows are more risky due to the age and condition of the portfolio. Cashflows are more likely to be negatively impacted through the capital intensive nature of an older portfolio.

The valuation reflects the nature of the future cashflows and the assumption that a covenant would mean that the units would always have to be retirement/community stock and never sold to crystallize highest and best use capital gains. A transfer would only occur if they buyer agreed to:

- honour the tenancies that are currently in place;
- continue providing housing to those Retirement and Community housing eligible people in perpetuity, and
- NCC maintaining a right of first refusal should the CHP ever want to sell the portfolio.

The earning potential of the portfolio is greatly reduced as the CHP has no ability to realise its highest and best use. The only source of cashflow is from the net rents charged to tenants.

Therefore, CHPs would look at the expected cashflows of the portfolio and discount these at a level they consider appropriate to estimate the lifetime cashflows of the portfolio. The resulting net present value would be the value they assign to the portfolio, plus any undeveloped land.

Current NCC "Book Values" - 2020

Below, we present the book value of the NCC portfolio as at 20 March 2020. These values were provided on a village-by-village basis by Telfer Young.

The Market Valuation represents highest and best use (e.g. capitalised 'market' rent, or redevelopment value). On a DCF basis relative to actual contract, the Transaction Value would be materially lower than the 'market' value taking into consideration sitting tenants, policy rentals and subsequent forecast cashflows.

	Market Value as at 20/03/20
Arthur Richards Village - 51 Units	$ 8.06m
Centennial Village - 40 units	$ 6.62m
Coventry Avenue - 31 units	$ 4.91m
Rangi-Marie Village - 16 units	$ 2.99m
Oriel Place - 20 units	$ 3.07m
Otatara Village - 12 units	$ 2.27m
Henry Charles Village - 80 units	$11.10m
Hastings/Munroe Village - 4 units	$ 0.97m
Greenmeadows East Village - 51 units	$ 8.93m
Total Retirement Villages	$48.9m
Nelson Place - 12 units	$ 2.86m
Carlyle Place - 32 units	$ 7.05m
Wellesley Place - 28 units	$ 6.25m
Total Social Villages	$16.1m
Total Portfolio	**$65.0m**

PwC

A CHP's potential cashflows

[redacted]

CHP cashflows

Under IRRS policy, a CHP receives market rent on the units in its portfolio. The market rent consists of 25% of the tenant's net income/benefit and the difference between this implied rent and market rent is 'topped up' by MSD. This benefits a CHP as rent increases are **not restricted by tenant affordability**.

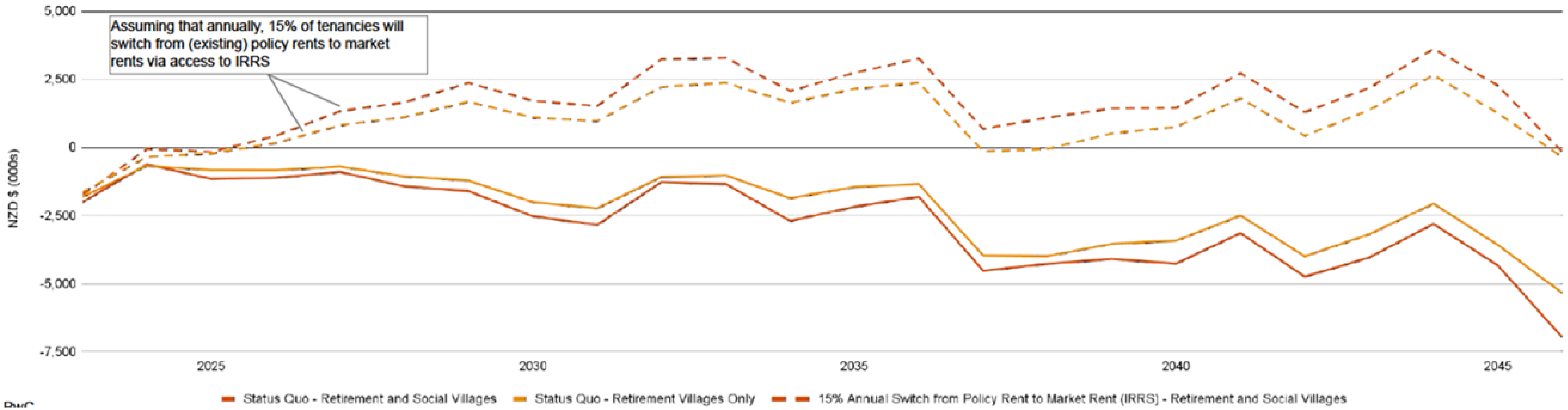
For CHPs, IRRS is only granted to those tenants who come off the MSD social housing register. This means that upon transfer to a CHP, none of NCC's current tenants would receive IRRS. Only once a sitting tenant vacates their tenancy/unit and is replaced by an incoming tenant off the MSD register will a CHP receive market rents on that unit.

Based on the current tenant turnover, a CHP might assume it is able to replace current tenants with individuals off the MSD register at a rate of 15% per annum. This means that annually, 15% of tenancies might be able to switch from existing policy rents to market rents via access to IRRS. Under this assumption, it will take **seven** years for the portfolio to achieve 100% IRRS eligibility.

For our modelling we have assumed the date of transfer to a CHP will be 1 July 2022. In this case, 100% of the portfolio could be eligible for IRRS by 1 January 2029. After such point, the CHP would be receiving market rents.

[redacted]

Net cashflows (excl. financing)



PwC

Kāinga Ora's potential cashflows

[redacted]

Kāinga Ora cashflows

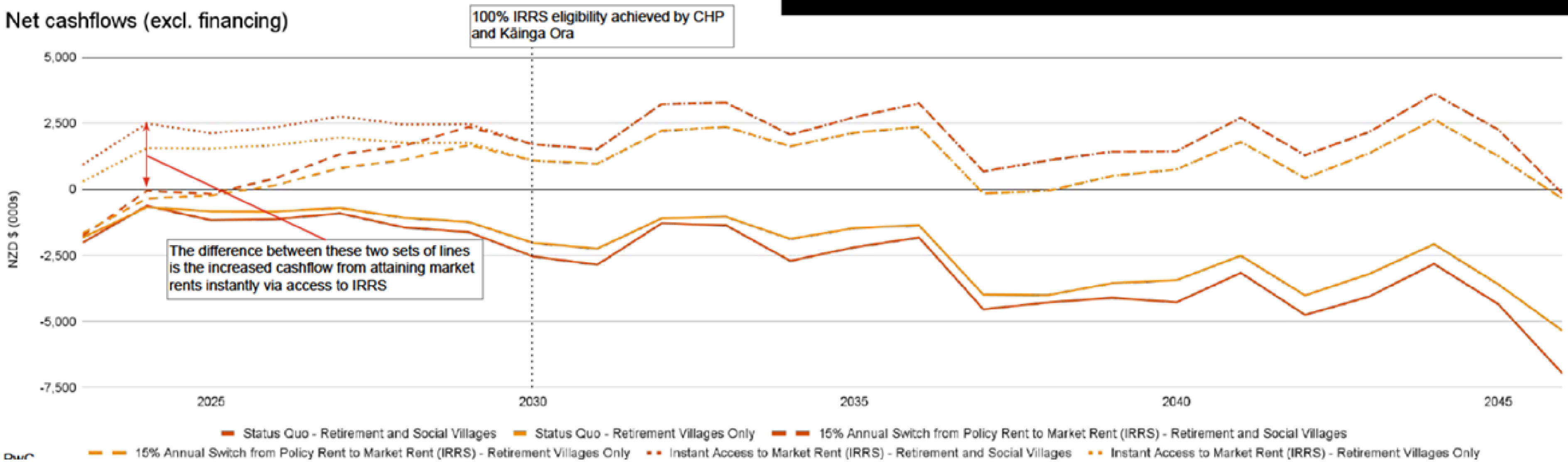
If Kāinga Ora were to purchase the portfolio, the existing eligible tenants would (we understand) be granted IRRS on transfer as occurred under the Nelson CC transfer of 2021.

For our modelling, we have assumed that 90% of existing tenants are eligible for IRRS. Market rent would be achieved instantly across 90% of the portfolio, with the final 10% taking approximately seven years (same timeframe as a CHP). This is because we cannot determine how long it would take for those 10% non-eligible tenants to vacate, so have assumed the same rate as the CHP IRRS uptake.

Kāinga Ora's potential cashflows are shown by the dotted lines below. Note that the cashflows are higher than a CHPs (dashed lines) in the years before 2030, as Kāinga Ora would have instant access to IRRS for eligible tenants. After 2030, the cashflows of Kāinga Ora and a CHP would be similar, as 100% of tenants would be receiving IRRS under both parties.

[redacted]

Net cashflows (excl. financing)



PwC

Transfer Evaluation

Transfer via a sale will provide either income returns from reinvestment or a positive impact from recycling of the capital AND avoid annual ratepayer contribution of ~ $2.2m to $2.3m

Observations

A transfer to a CHP or Kāinga Ora achieves all of the relevant NCC evaluation criteria, while also having a positive impact on tenants and ratepayers. The difference between the two [redacted] whether NCC is comfortable with the portfolio becoming 'Social housing' as opposed to 'Retirement housing' and whether, indeed Kāinga Ora is an interested purchaser. [redacted]

	Transfer portfolio		
	Wider Market (without constraint)	CHP	Kāinga Ora
Achieving City and Community Goals	✗	✔	✔
Quality Fit for Purpose Housing	✗	✔	✔
Protecting Tenants' Interests	✗	✔	✔
Sustainable Financial Outlook	✔	✔	✔
Tenant impact	✗ Less affordable housing for tenants	✔ Slow transfer to IRRS eligibility. Rent contr bution reduces from 30% to 25% of income	✔✔ IRRS granted immediately for those eligible(as we understand it). Rent contribution reduces from 30% to 25% of income
Ratepayer impact	↑ [redacted] indicative return on invested sale proceeds (4-6% p.a.)	↑ [redacted] indicative return on invested sale proceeds (4-6% p.a.)	↑ [redacted] indicative return on invested sale proceeds (4-6% p.a.)
	PLUS avoid annual ratepayer contributions of between ~$2.2m and ~$2.3m by retaining the portfolio		

PwC

[redacted]

Regional Trust Option

There is a potential for the region's councils to 'pool' their portfolios and form a Regional Housing Trust and there is an intention to discuss this further with the other councils to understand the shape of a possible Trust. Whilst a potential structure has yet to be developed, we note the following key points:

- CHP status and access to Crown funding streams (IRRS and Operating supplements) are critical for establishing a financially sustainable housing model.
- Under current legislation, local authorities and council-controlled organisations (CCO's) are excluded from registering as a CHP and securing access to IRRS.
- A **subsidiary** of a local authority or CCO may apply to register, so long as it is operating at arm's length from the local authority - must be genuinely operating independently i.e. not part of the parent body's corporate structure. To achieve this independence, a transfer of the assets is likely to be required, ether via a sale or a lease to the third party.
- As reported in October 2020, examples of where other local authorities have formed trust partnerships or CCO's suggest that transfer benefits to the councils are limited; e.g.Christchurch City Council which formed a Trust partnership with a CHP via a lease receive minimal annual rent and still have responsibility for CAPEX; Auckland City Council which transferred 51% of its interest in its elderly housing portfolio to a Limited Partnership and formed a CHP receive a peppercorn rent only and $2m towards capital works but still retain ownership of the housing and wider CAPEX responsibilities.

Ultimately, it is probable any likely structure proposed for a 'Regional Trust' will require a 'transfer' of the NCC housing portfolio (sale, either directly or 'effectively' via a lease) to secure Crown funding.

5 Potential transfer pathways

Potential retain portfolio pathways

Under this section we have undertaken a high level analysis of the varying options, applying a Red, Amber or Green (RAG) ranking to summarise and compare across financial, strategic and implementation risk perspectives.

Status Quo

Under the Status Quo option, NCC will need to consider how it will address the increasingly large future cash shortfalls. This likely means that ratepayers will need to pay higher rates as it is not sustainable to continue taking loans to support the portfolio.

Financial outlook

Rents under the current policy at 30% of tenant income/benefits are insufficient to fund (sustainably) the R&M and CAPEX needs of the aging portfolio. Under this policy, rents are tied to increases in NZ Superannuation and other benefits. They are unlikely to increase at a greater rate than capital goods, for example.

NCC may need to reconsider its rent setting policy to a percentage higher than 30% of income thresholds to decrease the cash shortfall incurred by the portfolio each year.

The negative cashflow position of the portfolio increases in magnitude over time. Therefore, opting for the Status Quo with the intention of reassessing the housing portfolio at a later date will only amplify the financial constraints faced today.

Strategic alignment

This scenario aligns with the key outcome of protecting tenants interests as there is no change to their current situation. While protecting the current tenants, this option negatively affects ratepayers and future tenants. Unless NCC increases rates or takes out additional loans to satisfy renewals, future tenancies will be in units of even poorer condition.

As the Status Quo fails to deliver positive cashflows, undertaking village expansions or developments is highly challenged. The existing unmet demand (waitlist) and forecast growth for affordable housing is not addressed, exacerbating this issue in the future.

Implementation risks

There are no implementation risks under the Status Quo as NCC would not be making any significant changes to community housing provision. However, consultation regarding substantial rates increases would be required.

Part retain/part sell

The Social villages could be sold (to a CHP) as of 1 July 2022 with sale proceeds being reinvested in the Greenmeadows East and Hastings/Munroe sites over the following five years.

There would be 38 new units constructed at vacant Greenmeadows East site and the the four units at Hastings/Munroe would be demolished and replaced with 11 new units; Hastings/Munroe units could be rented to the private market as a source of income to support the rest of the portfolio.

Financial outlook

The sale proceeds will not be sufficient to offset the development costs of the two sites. Therefore, ratepayers would be required to cover the difference in costs.

The annual cashflows following construction of the new units are improved (reduced shortfall) relative to the Status Quo option as NCC would have divested the underperforming Social village assets. However, while having a positive impact on cashflows, the market rents achieved on the 11 units at Hastings/Munroe would not be enough to make a significant impact to cashflows on their own. Overall, the portfolio is still unsustainable due to the continued negative cashflows.

Strategic alignment

Part retain/part sell does align with NCC's strategy as it will provide an additional 45 units (34 affordable, 11 market) of housing stock in the city. However, it only partially achieves the goal of improving village amenity as NCC would be unable to significantly refresh the portfolio with higher quality units.

Implementation risks

NCC may face criticism through the disposal of the three Social villages. However, these would presumably be sold with covenants in place to protect the current tenants. There may be perceived risk to the existing four occupants of the Hastings/Munroe site in relation to termination or relocation, albeit, the intent is to rehouse these occupants to other retirement villages.

Potentially significant risks are also implicit with development in relation to consents, contractor availability, timing and cost escalations.

Additionally, consultation regarding substantial rates increases would be required.

Potential transfer portfolio pathways

Wider market

The portfolio would be sold to the highest bidder without covenants or controls.

The bidder would pay a premium reflecting the ability to redevelop the land for its highest and best use.

Financial outlook

This option will realise the greatest sale receipts for NCC as the purchaser would buy the portfolio at 'market value'. Proceeds could be used to fund (recycled) other NCC projects or reinvested.

There would relieve ratepayers of supporting the housing portfolio.

Strategic alignment

A sale to the private market is inconsistent with NCC's strategy of providing community housing in Napier. Current tenants could have their tenancies cancelled and would be forced to find alternative housing.

Furthermore, this strategy could lead to more unaffordable housing in the city. Albeit, sale proceeds could be directed to the development of affordable housing, but this would take time.

Implementation risks *

The risks of implementing this option are significant. Public opposition is likely, as this strategy may be viewed as Council opting for a short term "money grab" without considering long term effects.

CHPs

NCC would transfer the community housing portfolio to a registered CHP. Covenants would be included in the sale that would ensure the villages continue to serve the community as it currently does (into perpetuity) and providing NCC a right of first refusal should the CHP wish to sell the portfolio.

Financial outlook

A transfer to a CHP would provide a positive cash inflow (sale receipt) upon sale, and relieve ratepayers of supporting the housing portfolio.

[redacted]

Strategic alignment

This would align with NCC's intention to provide community housing in the city. The CHP might be able to improve the amenity of current villages and even increase the supply of affordable housing.

Tenants may have increased access to wrap-around services.

Implementation risks *

This option has the lowest implementation risk of the three transfer options. NCC would need to assure tenants and the community that the services provided will remain the same (potentially improved), as those provided by NCC currently.

Kāinga Ora

Under this option, the portfolio would be transferred to the central government under Kāinga Ora. The transfer and covenants would be the same as a transfer to a CHP.

The ownership of the portfolio would simply be switched from Local government to Central government and therefore remain in 'public' ownership.

Financial outlook

A transfer to Kāinga Ora would provide the same financial benefits as a transfer to a CHP, [redacted]

Strategic alignment

As with a transfer to a CHP, a transfer to Kāinga Ora would align with NCC's strategic goals.

A point of difference would be that the process of transferring the portfolio to Kāinga Ora before approaching CHPs would limit complexity.

Implementation risks *

The risk of a transfer to Kāinga Ora is that there is no distinction between Social and Retirement tenants on MSD's register. This means that the villages would become a mix of Social and Retirement tenants, which some tenants may view as detrimental.

*Two sites (Hastings/Munroe and Carlyle Village) are subject to the requirements of both the Napier Borough Endowments Act 1876 (NBEA) and Local

Our recommendations

Key findings

- **The Status Quo** retains security for the current tenants, but at a significant cost to ratepayers. It does not contribute to Napier's ability to grow community housing needs, nor does it address fit for purpose consideration of the units. We have estimated that over the period to 2046 the annualised cost to the ratepayer to fund the shortfall (to break-even) will be circa $2.2m (excluding financing) per annum.
- **The part retain/part sell** option only marginally improves the cashflow position after 2028 - the cashflow injection from sale proceeds and rent from new units falls short of redevelopment costs. Over the period to 2046, we have estimated the annualised cost to the ratepayer to fund the shortfall (to break-even) will be circa $2.3m (excluding financing).
- In order to achieve financial sustainability under the Status Quo, retirement policy rent would need to be set at around ~78% of market rent and social tenancy rent at ~63% of market rent over the next 25 years to break even. This would equate to ~49% of an individual retirement tenant's income and ~32% of an individual social tenant's income. In order to achieve financial sustainability under the Part retain/part sell option, retirement policy rent would need to be set at ~74% market rent (equating to ~50% of a retiree's income). Setting rental policy at these levels would represent a significant increase in rents and would not align with the Council's current objectives of providing affordable housing.
- CHP status and access to Crown funding streams (IRRS and Operating Supplements) are critical for developing a sustainable commercial model that can grow social housing stock and renew the portfolio without creating a burden for ratepayers.
- NCC's portfolio is attractive to CHPs as their focus is to invest in the 'golden triangle' - high growth, high need and fair return. Of the parties approached, purchase was the preferred form of transfer. A leasing model does not enable a CHP leverage for funding for renewal or development aspirations.
- Kāinga Ora has emerged as a potential important shareholder in the community housing sector and may present an alternative to the CHP sector; it is the key government entity with the mandate to deliver on social housing. Whilst Kāinga Ora's key focus is 'Additionality' (ability to provide NEW housing supply), Kāinga Ora did, in March 2021, purchase Nelson City Council's community housing portfolio.
- Whether the portfolio is transferred to a CHP or Kāinga Ora, the Transaction Value would be materially lower than the 'market' value. Market Value represents highest and best use (e.g. the greater of capitalised 'market' rent, or redevelopment value). Both a CHP and Kāinga Ora would assess the transaction value based on discounted cashflow (DCF) analysis of future net cashflow reflecting rental income net of operating and maintenance and CAPEX costs, and with a covenant that locks in community housing into perpetuity, and would not value 'higher and better' alternative use.
- [redacted]
- Transfer via a sale would be expected to provide benefits to ratepayers as a result of income returns from reinvested capital or a positive impact from recycling the capital, together with avoided costs equivalent to circa $2.2m and $2.3m per annum.
- Additionally, a transfer to a CHP or Kāinga Ora would benefit the tenants; potentially, eligible tenants for IRRS (we estimate to be 90% of current cohort) would experience a decrease in their rent contribution from 30% to 25% of net income. This benefit would be realised (almost) immediately by the eligible existing tenants with a transfer to Kāinga Ora and to eligible new incoming tenants under a transfer to a CHP.

Our recommendations cont.

Recommended pathway

NCC has a mid-sized and aging portfolio of housing which requires significant capital investment over the next 25 years with an estimated annualised cost to the ratepayers of circa $2.2m (excluding financing) to meet the shortfall if the Status Quo is retained. Actively managing the portfolio (part retain/part sell option) in-house does not improve the financial position and creates additional complexity. A portfolio transfer by way of an asset sale to an established CHP or Kāinga Ora appears to represent the best value for money option for NCC' to meet its community housing objectives. This option would also be expected to improve tenant wellbeing via access to wrap-around services; structured correctly this option could:

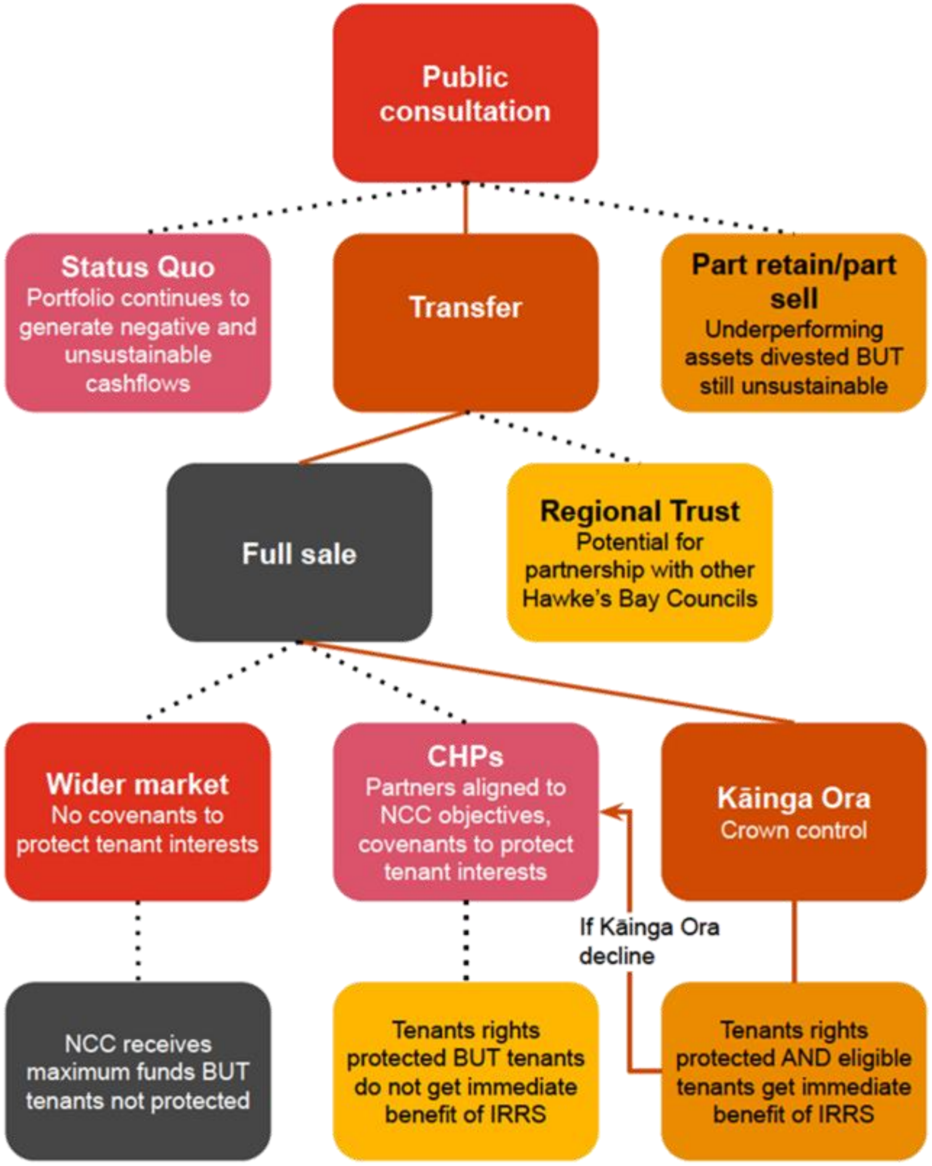
- Provide secure and affordable tenure for council housing tenants;
- Potentially deliver better, 'wrap-around' services for the tenants and potentially improve tenants' financial positions with decreased rental contribution relative to their net income;
- Facilitate growth in the volume and quality of housing stock within the portfolio through access to Crown subsidies;
- Improve financial outcomes for ratepayers, by transferring an otherwise ongoing liability.

If a transfer option is to be pursued by NCC, approaching Kāinga Ora to discuss options in the first instance would be a logical first step.

Key to the success of a sale to a CHP or Kāinga Ora will be NCC's management of the process including:

- Provision of a reliable, comprehensive, information memorandum incorporating detailed vendor due diligence;
- Communication and public engagement;
- A dedicated team of Councillors to provide a clear transaction mandate and Council staff to support the transition;
- Engagement and negotiation with bidders;
- A comprehensive framework for bid evaluation which incorporates social performance factors;
- Establishment of conditions of sale to protect Council housing occupants.

[redacted]



6 Appendices

Appendix 1 - Hastings/Munroe potential redevelopment

[redacted]

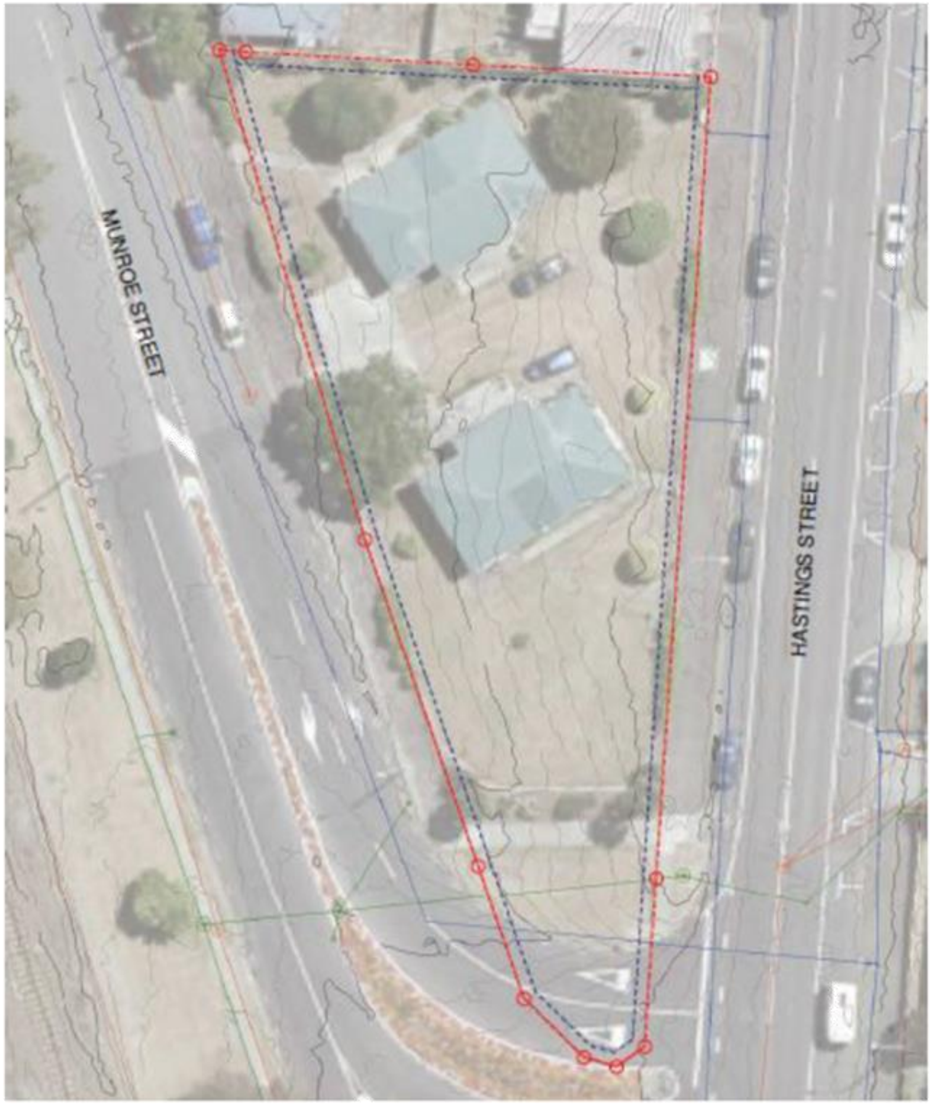
Hastings/Munroe Village

465 Hastings Street & 118 Munroe Street, Napier South

Comprising four single bedroom semi-detached units in average but tidy condition.

Key Stats:

- 4 Beds
- $24k gross rental p.a circa 40% of the estimated market rent
- ~ $87k annualised R&M
- $72k Capex forecast over next 10 years (minor works only)
- 1,826m² site
- Site coverage ~ 10%
- Potential to redevelop the site



Appendix 1 - Hastings/Munroe potential redevelopment

2 bed

Indicative cost $6.3m ($572K per unit)

11 units / 26 beds
mix of 2 and 3 bed
2 storey

~98m^2 per unit

Lease at market rents

Appendix 1 - Greenmeadows East potential intensification

[redacted]

Greenmeadows East

83 Tait Drive, Greenmeadows

50 semi-detached single storey, one bedroom retirement units and one community housing three bed house configured around a central car park constructed in 1980.

Key Stats:

- 53 Beds
- $321k gross rental p.a circa 44% of the estimated market rent
- ~ $102k annualised R&M
- $2.00m Capex forecast over next 10 years (moderate works on the complex as a whole)
- 19,305m² site
- Site coverage ~ 10%
- Potential to extend village on adjoining NCC land

Appendix 1 - Greenmeadows East potential intensification

Indicative cost $18.7m
($492K per unit)

38 units / 56 beds
mix of 1 and 2 bed
Mix walk up & 2 storey

~62m^2 - 79m^2 per unit

Retirement housing

Indicative cost estimates as per quantity surveyors advice, Rider Levett Bucknall as at February 2021.
Estimates are inclusive of all development costs including fees, housing, landscaping, utility provision and connection, landscaping, roadways and vehicle crossings.
Housing has been assessed at Good Quality Social Housing with all amenities including heating, basic appliances and window treatments. Fencing has been allowed to all separate properties.
GST, Land purchase and potential Resource Consent hearing costs are EXCLUDED.

Appendix 2 - Cost estimates from RLB (QS)

Rider Levett Bucknall

Napier City Council Community Housing Development
Concept Design Estimate (Mar 2021)
Location Elements Item

A MUNROE VILLAGE / HASTINGS Rates Current At March 2021

Description	Unit	Qty	Rate	Total
SP Site Preparation				
1 Prepare Site for housing	No	11.0	3,000.00	33,000.00
2 Utilities, Roading and Lighting to Section	No	11.0	35,000.00	385,000.00
3 2 Bedroom Two Storey unit - Concrete slab (98m2)	No	7.0	400,000.00	2,800,000.00
4 3 Bedroom Two Storey unit - Concrete slab (98m2)	No	4.0	400,000.00	1,600,000.00
5 Utility connections per unit	No	11.0	3,000.00	33,000.00
6 Landscaping to each unit	No	11.0	8,000.00	88,000.00
7 Paving for Vehicle traffic (say Asphalt)	m²	295.0	150.00	44,250.00
8 Paving for Pedestrian traffic (say Asphalt)	m²	181.0	120.00	21,720.00
9 Common Landscaping	Item			5,000.00
10 Vehicle Crossing at footpath	No	8.0	3,000.00	24,000.00
11 Fencing for units	Item			35,000.00
Site Preparation				*$5,068,970.00*
CN Contingencies				
12 Contingency 7.5%	Item			380,000.00
Contingencies				*$380,000.00*
PF Professional fees				
14 Consent, Consultants	Item			Included
Professional fees				*Included*
ES Escalation to Contract Completion				
13 Cost Escalation to 2026 - 16%	Item			872,000.00
Escalation to Contract Completion				*$872,000.00*
NA Not Applicable				
15 Land Purchase	Item			Excluded
16 Resource Consent hearings	Item			Excluded
17 Development Contribution	Item			Excluded
18 GST	Item			Excluded
Not Applicable				*Excluded*
MUNROE VILLAGE / HASTINGS				*$6,320,970.00*

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Rider Levett Bucknall

Napier City Council Community Housing Development
Concept Design Estimate (Mar 2021)
Location Elements Item

B GREENMEADOWS EAST VILLAGE Rates Current At March 2021

Description	Unit	Qty	Rate	Total
SP Site Preparation				
19 Prepare Site for Single Storey housing	No	12.0	4,000.00	48,000.00
20 Prepare Site for Two Storey housing	No	8.0	4,000.00	32,000.00
21 Prepare Site for 1 Bed walk-up housing	No	8.0	4,500.00	36,000.00
22 Prepare Site for 2 Bed walk-up housing	No	10.0	4,500.00	45,000.00
23 Utilities, Roading and Lighting to Sections	No	38.0	35,000.00	1,330,000.00
24 1 Bedroom Single Storey unit - Concrete slab (64m2)	No	12.0	290,000.00	3,480,000.00
25 2 Bedroom Two Storey unit - Concrete slab (98m2)	No	8.0	395,000.00	3,160,000.00
26 1 Bed walk-up unit - Concrete slab (61m2)	No	8.0	270,000.00	2,160,000.00
27 2 Bed walk-up unit - Concrete slab (79m2)	No	10.0	330,000.00	3,300,000.00
28 Utility connections per unit	No	38.0	3,000.00	114,000.00
29 Landscaping to each unit	No	38.0	8,000.00	304,000.00
30 Paving for Vehicle traffic (say Asphalt)	m²	1,847.0	260.00	480,220.00
31 Paving for Pedestrian traffic (say Asphalt)	m²	717.0	200.00	143,400.00
32 Paving for Shared space (say Concrete)	m²	303.0	300.00	90,900.00
33 Common Landscaping	Item			30,000.00
34 Vehicle Crossing at footpath	No	34.0	3,000.00	102,000.00
35 Fencing for units	Item			90,000.00
Site Preparation				*$14,945,520.00*
CN Contingencies				
36 Contingency 7.5%	Item			1,120,000.00
Contingencies				*$1,120,000.00*
PF Professional fees				
38 Consent, Consultants	Item			Included
Professional fees				*Included*
ES Escalation to Contract Completion				
37 Cost Escalation to 2026 - 16%	Item			2,570,000.00
Escalation to Contract Completion				*$2,570,000.00*
NA Not Applicable				
39 Land Purchase	Item			Excluded
40 Resource Consent hearings	Item			Excluded
41 Development Contribution	Item			Excluded
42 GST	Item			Excluded
Not Applicable				*Excluded*
GREENMEADOWS EAST VILLAGE				*$18,635,520.00*

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PwC

Appendix 3 - Market sounding document

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

Disclaimer

This short form project flyer (Flyer) has been prepared by PwC Advisory Services (PwC), Licensed under the Real Estate Agents Act 2008, as advisor to Napier City Council (NCC) to engage with potential parties interested in the delivery of services and potential ownership of NCC's Housing portfolio.

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This Flyer has been compiled using information provided by NCC and information publicly available. Figures presented in this Flyer are quoted as GST exclusive. Gross Revenue and Repairs and Maintenance (R&M) figures have been sourced from NCC's Long Term Plan (LTP) 2021 - 31. Capital Expenditure (Capex) figures have been sourced from a report provided to NCC by a leading asset lifecycle management specialist, detailing forecast Capex. Note that Capex figures in the LTP are higher than those figures quoted in this Flyer as they also account for internal resources over and above estimated cost of physical works.

This Flyer has been prepared solely for information purposes in order to assist interested parties in making their own evaluation of whether they have an interest in this opportunity and does not purport to contain all information that an interested party may require. In all cases, interested parties should, amongst other things, conduct their own investigation and analysis of the information set forth in this Flyer.

Interested parties acknowledge that NCC and PwC disclaim any liability to reimburse or compensate any interested party for any costs, losses or expenses incurred by that interested party in evaluating an agreement or otherwise acting in connection with the process of evaluating the opportunity.

This Flyer is to be used to receive preliminary market feedback and is not part of a formal process to select a partner or similar. Selected potential partners may be afforded the opportunity in future processes to undertake due diligence to satisfy themselves as to the truth and accuracy of the information contained in this Flyer or that which is obtained from any discussions with PwC, NCC or their respective partners, directors, officers, employees, agents, advisers and representatives.

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Provision of this Flyer is not a representation to any recipient or any other person that an agreement with NCC will be executed in respect of the opportunity. NCC may at any time negotiate with one or more potential parties and enter into a contract without prior notice to any or all interested parties. Furthermore, NCC reserves the right to terminate, at any time, further participation in the proposed process by any or all parties, and to modify the proposed market engagement and procurement process.

Any agreement related to the opportunity will include an acknowledgement from the purchaser that, save in respect of those warranties and representations expressly included in the agreement, there has been no reliance on information, warranties or representations which may have been made by NCC or PwC, or any of their respective shareholders, partners, directors, officers, employees, agents, advisers and representatives and that the purchaser has relied solely upon its own investigation and enquiries in order to formulate its proposal and in entering into the agreement.

Respondents must direct all enquiries related to this IM through the sole agent, PwC, via John Schellekens or Kirstyn McKeefry.

Respondents should not directly or indirectly make contact with Stand regarding this opportunity.

Prepared in September 2021

PwC is engaging with a limited number of potential parties to understand interest and feedback on this opportunity.

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pwc

Thank you.

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