Kāinga Ora
Homes and Communities

Delivering more housing when it's needed most

COVID-19 and its ongoing effects are impacting the construction sector and house building nationwide. Kāinga Ora, like the private sector, is not immune to these pressures. Advice on how we are responding to these headwinds has been provided in a series of papers (ad hocs) and briefing notes to the Minister of Housing.

These papers *(insert link)* outline the advice Kāinga Ora has provided to the Minister of Housing since 2021 on the impact COVID-19 has had on its housing delivery programme since the first lockdown in 2020. Given cost pressures, there is also advice around future funding settings to sustain the increasing level of activity with our build programme and the renewal of our older housing stock.

These papers should be read in conjunction with advice Te Tuapapa Kura Kāinga - Ministry of Housing and Urban Development (HUD) has also released under the Official Information Act on the financial sustainability of Kāinga Ora and the impact of COVID-19 on its build programme.

HUD provides advice to the Government on housing and urban development and policy and legislative settings. It also monitors Kāinga Ora, which is the key delivery agency for supplying more public housing and is leading the largest urban regeneration ever undertaken in New Zealand.

Overview

Supplying more housing in a challenging environment

The papers and briefing notes to the Minister of Housing are included as part of an information pack to provide context on the impact of COVID-19 and broader market headwinds on the delivery functions and financial sustainability projections of Kāinga Ora.

In reading these papers it should be noted that the projections in them were based on a number of key operating and market assumptions and were provided in an evolving environment. For example when parts of New Zealand were going through level 4 and 3 lockdowns the advice was changing to reflect our operating environment. The advice therefore should be considered as updates on the impacts, not firm updates on forecasts.

These papers also show that Kāinga Ora was proactively informing and updating the Government, and HUD, about the impact of the pandemic on its build programme, which like the rest of the construction sector was, and continues to face, the challenge of supply chain constraints, materials and labour shortages and rising build costs.

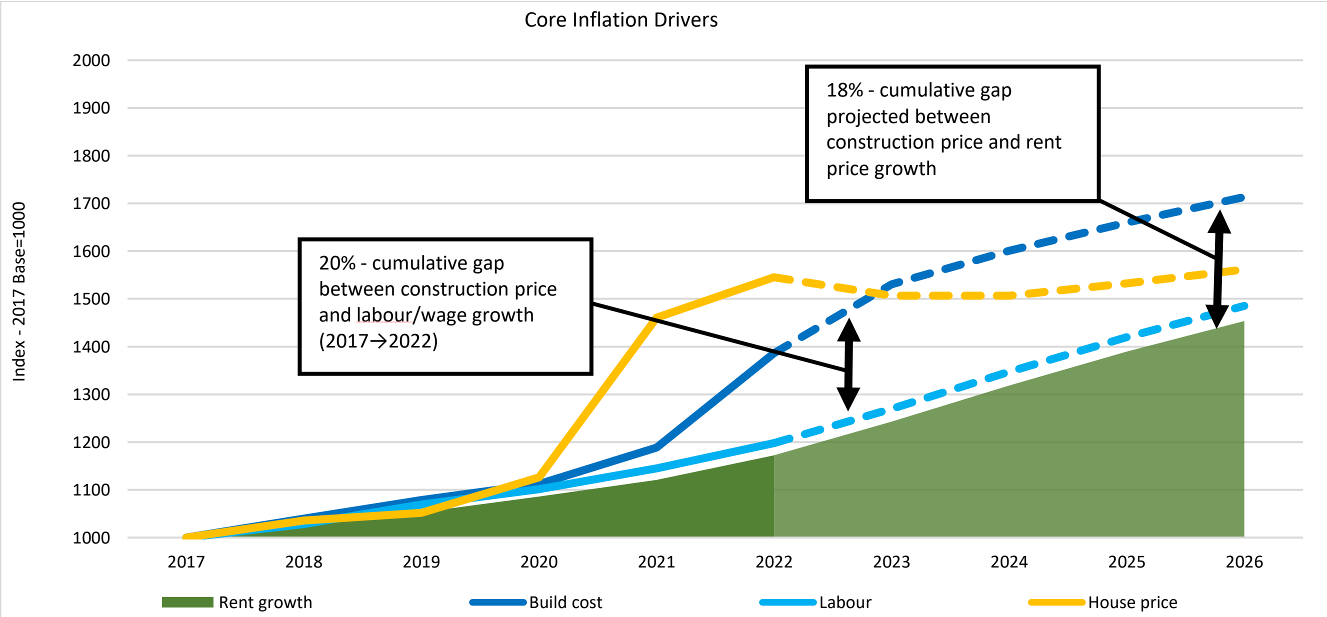
The costs of building a home in particular have increased by around 35 percent in two years. As all of our homes are built by the private sector, the cost increases and pressures being experienced by our builders, contractors and suppliers are being passed onto Kāinga Ora – the largest customer of residential building in the country.

These cost increases also impact on the cost to maintain our portfolio of nearly 70,000 homes and the work under to renew and upgrade around 45,000 of our older state homes within this over the next 20 years.

These sector headwinds are also acknowledged by HUD in its briefings.

As a long-term rental home organisation, Kāinga Ora is also affected by rising interest rates which have increased the financing costs of our build programme.

Alongside this our rental income, which is our primary source of income, has only increased by 18 percent over the past three years, while our costs have increased by over 30 percent over the same period.



Note: Data for this graph sourced from The Treasury Budget Economic and Fiscal Update May 2022

Impact of COVID-19

When New Zealand went into the first of several lockdowns starting in March 2020, it was an unprecedented situation for everyone, and the effects of it are still being felt in many sectors, particularly construction.

The uncertainty and the impact of the lockdowns on our operating environment meant Kāinga Ora, like all other organisations, agencies and companies had to flex and adapt to the ambiguity we were facing.

The impact on our build programme is highlighted by the several months Auckland spent at alert level 4 or 3 which severely reduced productivity on over half of the active Kāinga Ora build sites.

The restrictions rippled through every aspect of our build programme creating delays. These ranged from limits on the number of people on sites, a reduced ability to inspect works on over 500 construction projects, skill shortages, reduced speed which contractors could resume work, delays to our urban design work and to our civils infrastructure and geotechnical assessment of our land sites.

The impact on our operations and work programmes were based on five key operating assumptions that were, and continue, to have been significantly impacted by COVID-19 – both directly with restrictions within New Zealand, and indirectly by global shifts. They are:

Assumption	**Areas of impact**	**Activity**	**Example**
We work face-to-face, in person, in homes	Community relationships Customer relationships Rehousing customers	Urban development planning Maori engagement Community engagement Maintenance Customer support Home inspections	Our business model assumes we: • Can work with our customers to manage debt, rehouse and let homes • Can engage in a meaningful way with the community • Can inspect our properties and undertake maintenance work in our tenanted properties such as our Healthy Homes compliance work • Have the materials available to maintain and construct our homes e.g. insulation, steel mesh, etc on a Just-in-Time basis • Can move staff around the country to manage our redevelopment activity • Can carry out site inspections to plan work and commission technical reports as required • Can inspect work underway and ensure it meets our standards
We have external products and suppliers available to us	Material supply Labour supply and productivity Logistics	Maintenance Construction Land development	
Employees can operate at scale nationally	Community relationships Organisation productivity Quality control Procurement	Maintenance Construction Land development	
We have access to work sites	Organisation productivity Project/programme supervision Quality control Procurement	Construction Land development Land acquisition	

We can use people intensive practices	Labour supply and productivity Organisation productivity Project/programme supervision Quality control	Construction Maintenance	

This meant we were having to review and reset many aspects of our build plans and reassess our delivery timeframes, many of which were extended by around six months, which is reflected in the advice. This recalibration and delays also contributed to significant cost increases.

While we were managing this fluidity, we also took actions to support our build partners and suppliers to ease their financial burden. This included adjusting our contracts to increase cash flow, while also accelerating project planning to provide more work for our suppliers.

The impact of the lockdowns extended beyond our build programme with the delays and restrictions being felt in our maintenance work and our programme to meet the Healthy Homes standards.

With our customers, our teams rallied to support those affected with contact made to over 42,000 households to check on their welfare while we partnered with agencies to provide meals and other necessities to the most vulnerable.

Renewing homes and supplying more new builds

To provide the warm, dry and healthy housing people need, Kāinga Ora is renewing and upgrading 45,000 of its older homes – a massive programme. This work can include full insulation (walls, ceiling, and floor insulation), adding double-glazing, improved air-tightness, ventilation, and new heating. In some cases, new kitchens or bathrooms maybe installed as well adding 50 years to the life of a home.

Alongside this we have a maintenance programme which responds to around 500,000 requests a year, with nearly half a billion dollars spent yearly on maintaining our homes.

This work is part of the Government's housing programme which is also seeing the largest number of newly built public homes being supplied in a generation, while Kāinga Ora and Community Housing Providers have delivered over 10,000 additional public houses since mid-2017.

The scale and pace of housing delivery has been steadily increasing with over 8,100 newly built public homes delivered by Kāinga Ora in the past five years This is despite the headwinds and setbacks generated by COVID-19.

We are also undertaking several urban redevelopments projects in Auckland and Porirua – the largest ever seen in New Zealand - which are supplying thousands more homes. This land redevelopment has also enabled over 4,000 market, affordable and state homes enabled in the past five years.

To help meet the Government's housing priorities, we are channelling 40 years of house building and renewal of our housing assets into a decade.

The requirement for us to renew and upgrade our homes also comes at time of record demand for public housing – we need more homes, not less so the pace of supply needs to continue.

Our investment decisions and spend is directed towards meeting these priorities, some key ones being – increasing housing supply and providing warm, dry homes for our customers. The Government has committed, through its Public Housing Plan 2021-2024, to deliver an additional 18,000 public houses by mid-2024, of which Kāinga Ora will supply the vast majority. That's one of the primary drivers underpinning our investment decisions.

As a crown entity, we're building our homes to a higher standard than most private sector rental homes - this reflects the fact we are a long-term owner of these homes (they are built to last for at least 60 years) and house some of New Zealand's most vulnerable people. This includes meeting HomeStar standards, including accessibility features in up to 15 percent of our new builds and adding community areas in our larger developments.

While building and upgrading these homes, we also need to meet additional costs associated with the Healthy Homes Guarantee Act, make more of our new homes meet accessibility requirements and respond to the need to reduce carbon emissions through the Carbon Neutral Government Programme.

This is additional work, across tens of thousands of homes, which Kainga Ora had previously been able to absorb within its rental streams, however construction cost increases and increased interest rates mean this is no longer possible.

Kāinga Ora key funding sources

Kāinga Ora uses the rental income from our homes to maintain and renew our properties, providing warm dry housing to nearly 200,000 New Zealanders.

The capital cost for new homes is met through borrowing with the interest and principal repaid over the life of the home.

Kāinga Ora receives appropriations from the government to cover the costs associated with Urban Development planning, Sustainability functions, Māori and iwi engagement, and administration of Crown functions such as Kiwibuild and the Infrastructure Acceleration Fund.

Urban development capital costs for programmes like the Large-Scale Projects in Auckland and Porirua and the Kāinga Ora land programme are met from land sales and some appropriations.

Financing

To finance its build programme, since 2018 Kāinga Ora has borrowed from private markets through our Sustainability Financing Framework. Future borrowing will now be through New Zealand Debt Management.

This debt has been invested in thousands of new houses which will generate rental income for the next 50-60 years, which over the long term repays the borrowing of the homes.

The cost of doing more and taking a long-term view

Kāinga Ora is financially sustainable.

The advice that we have provided to Ministers shows that due to a range of rising costs which are increasing at a rate higher than our income, a situation not unique to Kāinga Ora - our cash flow is being squeezed over the next two years.

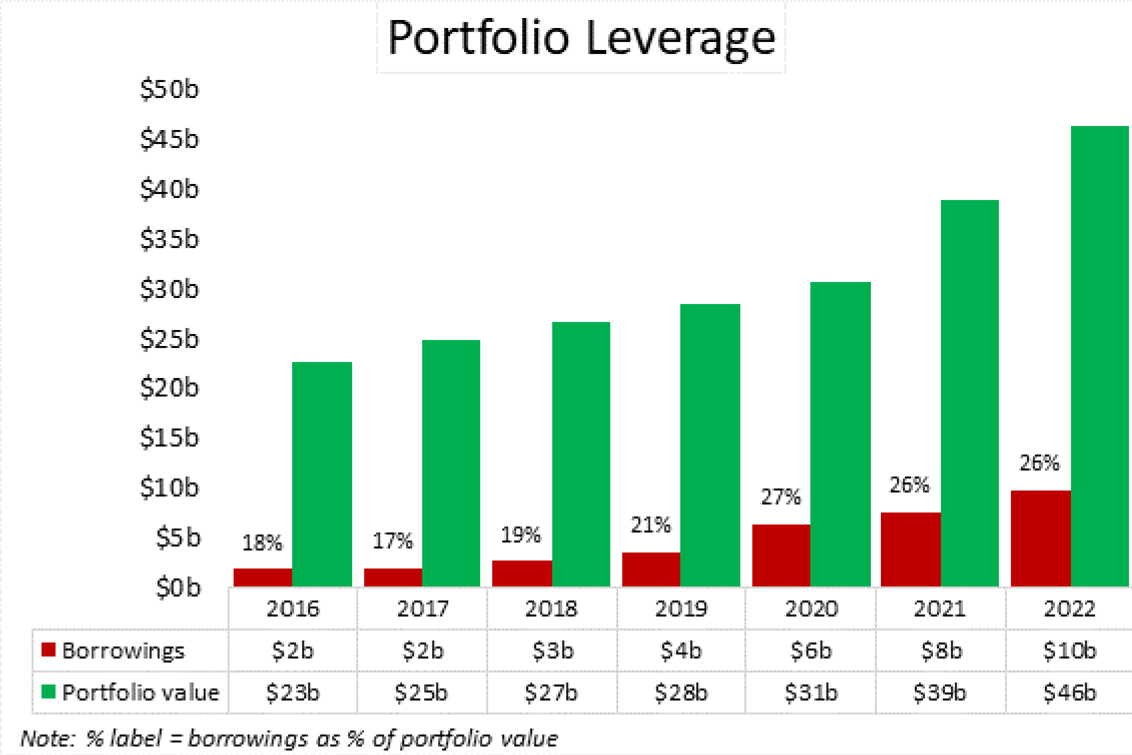
From 2025/26 we will start to see the difference in costs and income level out, but if additional homes are required beyond the timeframe set by the Public Housing Plan, the funding model will need to change. Some of the advice provided by other agencies on Kāinga Ora debt and concerns about its future levels and the ability to service the finance costs requires context.

As an agency with one of the largest asset bases for the Crown, we take a long-term, fiscally responsible view with managing the housing portfolio. This involves looking at our plan to grow, maintain and renew the portfolio over the next 60 years and this has been reflected in the advice provided.

Over that 60 –year period, with the scale of the new building currently underway, and the large existing asset base, Kāinga Ora will be better off in the long term.

While the level of debt we hold will rise as we renew our homes and build more, the value of our assets and income levels will grow. In 2021/22, the value of the housing portfolio increased by nearly $8 billion – roughly the same amount as our debt.

To provide context, it’s forecast that by 2081 our balance sheet will have an estimated $260 billion in total assets. By this time, the debt Kāinga Ora holds will be very small relative to our assets – around $9 billion, which is a debt to assets ratio of 3.5%, which is a very low level of debt by any standard, for a Crown Entity or a commercial operation. As we build more homes, our income streams increase which means we will have the ability to repay the debt over the long term.



So we can continue to deliver on the Government's public housing commitments and build the homes needed at the standards and specifications set by the Government, Kāinga Ora is working with HUD and the Treasury to review our funding and financing settings.

While this funding work is underway, Kāinga Ora has actions underway to improve our financial resilience and identify cost savings. Some of this work includes:

- reducing costs by finding efficiencies in our construction programme, an example being Project Velocity which identifies savings in the end-to-end build process
- longer term review of our maintenance operating model to identify savings. Maintenance costs will also reduce as more new homes are added to our stock
- reviewing plans for people growth
- ensuring spend priorities are aligned with core delivery

We continue to adapt and respond to the challenges we're facing to provide more homes for more people and renew our aging houses.

Summary of advice

The ongoing impact of COVID-19

Ad hoc 21 071, 14 September 2021

This paper advised on the impact of the COVID-19 level 4 lockdowns on Kāinga Ora delivery functions and understanding the short, medium and long-term impacts of the pandemic on the ability of Kāinga Ora to deliver on its housing supply commitments.

Briefing note 21 031, 13 October 2021

Further advice was provided setting out the delivery challenges of the level 3 and 4 lockdowns and the consequence of extended border closures and huge disruptions to international flows of labour and material supply chains and financial implications for the organisation

At the time this BN was written, Auckland was still in level 3, and since the first lockdown in March 2020, Tamaki Makarau had spent nearly six months at alert level 4 or 3 which severely reduced productivity on Kāinga Ora build sites, as just over two thirds of the homes under construction at that time were in Auckland.

Briefing note 21 040, 2 December 2021

This paper was in response to request about how Kāinga Ora could mitigate the delivery risks identified in BN 21 031

This advice noted at that time, we were identifying potential programme delays of up to six months, driven by the impact of FY21 and FY22 lockdowns, reduced builder productivity due to modified operational practices to reduce COVID-19 risks, and as a result of supply chain constraints with limited buffer stock on hand. These delays were resulting in a compression of the timelines to meet our FY24 commitments.

The paper outlined the key initiatives the organisation already had under way to accelerate delivery and identified some areas where government agencies could provide assistance.

Some of these initiatives include:

- moving the nearly 3,800 homes that are currently in feasibility and planning phases through to procurement and contracting
- Construction Partnering agreements – delivering time and cost savings through multi-year contracts with build partners for the annual delivery of a set number of homes
- off-site manufacturing (modular and panelised) - accelerating the delivery of these homes locally, while exploring offshore supply to complement domestic capacity
- initiation of Consentium, the Kāinga Ora Building Consent Authority, to provide faster and more cost-effective building consent services and to improve its building processes through greater consistency and transparency
- buying more serviced and consented land
- increasing the number of suppliers they work with
- improvements to its and suppliers design and build processes that will reduce construction

planning, design and building timeframes.

It should be noted that all the projections across AH 21 071, BN 21 031 and BN 21 040 in particular were indicative given these were written during various states of lockdowns.

Briefing note 22 003, 5 April 2022

By April 2022 the country was feeling the effects of the Omicron outbreak, so further advice was provided (**BN 22 003**) identifying the impact these factors were having on the delivery of our commitments, noting that while the organisation was committed to pulling all levers these will make meeting our commitments challenging.

While lockdowns had ceased this paper noted the significant challenges the construction sector and Kāinga Ora was facing including:

- reduced ability to access materials – the most recent example being the issues with GIB supply
- skills and labour shortages in the industry – driven by illness and isolation requirements, and exacerbated by the increased volume of work across the sector increasing demand for construction skills
- increased build costs
- the solvency of our build partners and their general ability/ preparedness to commit to new work
- competition from developers (though this is lessening slightly currently due to changing market conditions)
- feasibility of development in some areas given land and house prices.

The paper also committed to providing subsequent advice on its long-term financial projections, in particular the impact of cost pressures and inflation, and the implications of this on our funding settings, projected debt and our associated financing strategy. It should be noted that this advice was never intended to be a formal update of agreed forecasts rather a basis for discussion with the Crown.

While the building sector still faces significant challenges and headwinds, Kāinga Ora is committed to meeting its 2024 housing supply commitments and is prioritising actions to support that.

Financial Sustainability

Briefing note 22 025, 17 June 2022

This paper sought to provide:

- an overview of the current Kāinga Ora funding and financing model
- key commitments that a draft budget was seeking to deliver
- the need for clarity on further public housing growth beyond June 2024 as outlined in the Public Housing Plan

- the financial impact on the organisation stemming from the construction sector headwinds, coinciding with high public housing growth requirements and increased interest rates
- a summary of the mitigations we are undertaking to improve our financial resilience in areas within our control and areas where we think we need to work with the government to relook at the funding model.

This paper highlighted that while Kāinga Ora is pulling those levers within our control, the impact of the changes we can make internally through operational efficiencies or changes to the quality of product or service we provide, are dwarfed by the broader economic challenges we are facing. Without changes to our current funding model our ability to invest in further public housing growth (beyond current commitments) and meet the expectations set out for us both in the GPS HUD, and in our legislation around public housing and urban development delivery will be significantly constrained.

Kāinga Ora is financially sustainable. The production of long-term forecasts show that we are actively reviewing how market conditions could have an impact on our finances. This long-term view allows us to respond early and work with the Crown to make any changes that are necessary in line with section 51 of the Crown Entities Act.

Question and Answers

Financial sustainability

Q. Is Kāinga Ora financially sustainable?

Kāinga Ora is financially sustainable.

Like any private or public sector business or organisation, Kāinga Ora plans for both the current and possible future operating environments. Part of this is considering financial sustainability, while delivering on our housing commitments.

The emerging financial position for Kāinga Ora requires an understanding of balancing the need to do more, and the escalating cost of this increased activity. This requires both a short and long term perspective of potential financial scenarios to inform future decisions.

The scale of public housing Kāinga Ora is delivering is significant. We have delivered over 8,100 newly built public and supported homes in the past five years, with the number of new state homes being built the most in two decades.

There are also thousands more to come as Kāinga Ora currently has over 4,600 homes under construction or contracted to be built, with around 6,000 homes in the pre-construction phase. We have nearly 600 build sites active across the country and 4,000 market, affordable and state homes enabled in the past five years through land redevelopment.

However, like other organisations both domestically and internationally, we are facing inflationary pressures brought about by labour shortages and supply chain disruption, which have added significant costs to our build programme, and to the costs of maintaining our portfolio of around 70,000 homes.

We are also facing higher interest rates. Like others, we borrow to pay for building new homes upfront, and then service that debt from the income we earn on our new homes. This is becoming more challenging as costs have increased faster than our revenues. We are exploring a number of avenues to mitigate these impacts, including reassessing spend priorities that aren't aligned with core delivery, continuing a major construction efficiency programme, and changes to our funding model with the Crown.

The new homes needed come at time of record demand for public housing – we need more homes, not less, so the pace of supply needs to continue. This is at the same time that Kāinga Ora is facing the following increases:

- construction costs are up – the cost of building a new home has risen 37 percent over the past two years
- it costs more to maintain our homes, with materials and labour expenses rising significantly
- the interest costs to finance our build programme are increasing.

Q – Given the cost pressures Kāinga Ora is facing, what actions is it taking to mitigate these?
We are focussed on the prudent financial management of our operations and stewardship of our finances and we're exploring a number of avenues to mitigate the headwinds we're experiencing.

This includes actions to improve our financial resilience.

Some of the work underway includes:

- identifying cost savings through a major construction efficiency programme, with an example being Project Velocity which identifies savings in the end-to-end build process
- a reduction in maintenance costs with more new homes properties being added to our stock
- reviewing plans for people growth
- Ensuring spend priorities are aligned with core delivery

Q. Why did you raise the risk in the paper around short term pressures and issues with your funding model?

The Kāinga Ora Board has a responsibility under the Crown Entities Act to ensure its long term financial sustainability. This includes advising the Minister of Housing of possible challenging financial situations, and what we need to do about it, early to enable choices to be made.

As an asset intensive agency, Kāinga Ora actively monitors and forecasts long term financial impacts to ensure the right settings are in place to ensure continued financial sustainability.

The advice provided to the Minister was intended to highlight the impact of challenging market conditions over both a medium and long term period. Kāinga Ora, like other organisations (both public and private), is not immune to these market conditions and it is normal practice to forecast what the implications of doing nothing are, in order to assess if changes are needed.

The financial forecasts presented to the minister were based on current settings and assume these will not change. Alongside this, there is a range of scenarios developed as part of long-term investment plans that look to project outcomes under differing assumptions. This work is regularly refreshed and discussed with the Board, and provide a basis for engagement on the future financing and funding settings which will support future financial sustainability.

Given the financial impacts are first identified over the medium term [e.g., from 2025], Kāinga Ora is working with the Crown to ensure the right settings are in place to respond to the headwinds identified in the paper. This includes considering what options are available through the annual Budget cycles.

Q. The documents show Kāinga Ora debt will be unable to be repaid over the next 60 years. What is being done about it?

Over a 60-year period, settings will change, revenue and cost assumptions will fluctuate, market conditions will change and policy will evolve. That is why work is progressing on future financing and funding settings that will support future financial sustainability. As we build more homes, our income streams increase which means we will have the ability to repay the debt over the long term.

For context:

- the level of debt we are currently forecasting in 2080 is very small relative to the forecast value of our assets at that time, at around 10 percent. This is lower than the current level of debt to assets ratio, and would be considered to be a very low level of debt for an organisation of this size
- the debt projection at 2081 of $8.9 billion is equivalent to the Crown increasing equity holdings in Kāinga Ora by $2 billion in today's dollars
- Kāinga Ora, and its predecessor organisation Housing New Zealand have carried a level of debt around $2 billion for many years. It would not be considered good commercial practice to repay all its debt. Rather we should use our financing capacity to continue with regular capital investments into the portfolio, partly to mitigate the risk of requiring heavy capital investment over a shorter timeframe as assets require renewal. This is the challenge facing Kāinga Ora now due to previous decisions made to not renew/reinvest in the property portfolio
- it is estimated that by 2081 Kāinga Ora's balance sheet will have $260 billion in total assets and $233 billion in equity.

Exiting remote high-cost location

Q Are you looking to exit high cost remote locations? What will happen to these homes and tenants?

Kāinga Ora is looking at a range of options to improve the organisation's financial sustainability.

It should be noted that we have no intention to exit areas where there is ongoing demand should this option not be available. No specific locations have been formally discussed at this stage; however, these homes make up a very small proportion of our current portfolio - accounting for less than 1 percent of our managed stock. As we manage our costs on a portfolio basis, costs vary across different markets due to a range of reasons including typology, age of stock, access to services, availability of trades and climate.

We are still working through the cost to service modelling on these locations however remote locations tend to attract lower rents and cost proportionality more due to travel costs and access to tradespeople for example. Should we consider this a viable option in the future we would seek the Ministers advice before committing to any actions.