COUNCIL HOUSING PROVISION

STATEMENT OF PROPOSAL

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

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 costing more and more to maintain. Significant work is required in the near future to address deferred maintenance issues. 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[1]) 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) to an entity in the social housing sector
Deficit funded by: (a) Rates only (b) Subsidised rents only (c) Combination - Rates and subsidised rents	Deficit funded by: (a) Rates only (b) Subsidised rents only (c) Combination - Rates and subsidised rents	

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

[1] Income Related Rent Subsidy allows the 'landlord' to receive an agreed market rent through a combination of charging eligible tenants 25% of their income as rent with the balance to top up to market rent paid by the Government

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 and impacts to each party.

Status Quo – 377 units - $2.2 million deficit pa

Contribution Level to meet deficit	Ratepayer pays* (rates increase)	Tenant Retirement Pays (305 tenants) (rent increase pw) ** Current rent is $127 45% market rent	Tenant Social Pays (72 tenants) (rent increase pw)*** Current rent $151 39% market rent
100%	3.1% or $85per annum	Deficit split by tenant type – ‘ to break even’	
		78% market rent	63% market rent
		70% or $88pw increase ($215 rent pw) (51% of tenant income)	61% or $92pw increase ($243 rent pw) (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 all 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)
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[2] adjustments made in the alternate year. A 92% of market rent setting for all units, creates 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 until the full rent increase is applied, as outlined in the Long Term Plan 2021-31.

Retirement housing tenants receive an increase in income with annual Superannuation increases (with average wage 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). Note: the these amounts and relativities may change with updated market rental information.

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 deteriorating condition of the units, 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,

[2] CPI – Consumer Price Index or inflation rate

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 four units at the Hastings/Munroe village would be demolished and 11 new units would be built 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, there are 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).

Note: this option has a higher average annual deficit but lower overall shortfall (after 25 years) than the Status Quo option because in the earlier years there are significant costs to redevelop (not fully offset by the sale proceeds of the three villages) and lower rental income (until the new housing is completed). The shortfall reduces, although not to breakeven, in the latter part of the 25 year period as the new housing is complete and the income increases due to the combination of a near return to the numbers of units overall and the addition of the market rental properties.

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 any additional housing to be built to meet growing demand, or any upgrades to existing housing to meet modern living standards or accessibility. It does not address the issue of the deteriorating condition of the units, 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 (Sell) option

Description:

This option would see all 377 units transferred (sold) to another entity within the social housing sector.

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 out 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 in the Part Retain / Part Sell option, 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 Council's 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 be 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 types of entities that best align to Councils objectives as potential housing providers for a sale or to vest to, in the case of a regional or local trust.

Transfer to a CHP

The portfolio would most likely be valued on a discounted cashflow (DCF) basis. It is understood CHPs are unable to access IRRS for existing eligible tenants, affecting the cashflow initially. 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. Alternatively, a local housing trust could be established by Council and become a CHP.

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 require 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’, noting that the majority of CHPs are charitable trusts.

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 council formed regional or local housing trust would not provide any sale 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 might 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 transfer pathway 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. Selling through the open market 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, which is a key concern for Council. Sale through the open market is not being considered by Council.

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.