A review of Kainga Ora's financial position

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Introduction

This paper considers the financial health and wellbeing of the New Zealand Government's public housing agency – Kāinga Ora – Homes and Communities. It has been written as a resource for the Peoples' Review of Public Housing which will run between April and September 2024.

As a background resource this paper has two aims.

- To provide an analysis of Kāinga Ora's financial position based on publicly available information.
- To document the genesis of this financial position from political decisions taken by previous governments between 2016 and 2023.

This paper has been developed from the premise that publicly owned and provided affordable rental housing is an essential part of a housing system which is fair and just and that such ownership and provision can be economically efficient. In accepting this premise, the paper attempts to assess Kāinga Ora's operational shortcomings and critically examine the way two governments have approached the challenge of directing and supporting Kainga Ora and its predecessor Housing New Zealand.

Background

In June 2022 the Kāinga Ora's Chief Executive Andrew McKenzie warned the Ministers of Housing and Finance of the organisation's operational challenges and its difficult financial position[1]. The challenges identified in this advice included.

An aging public housing stock of which 45,000 houses will require major refurbishment or be replaced over the next 20 years.

Surging constructions costs in the post-COVID era making it difficult to maintain the volume of maintenance required for these renewals.

A capital funding problem which was compounded by high levels of debt, rising interest rates, high construction costs and inadequacy of future rents to fund these during the lifetime of the assets.

At that time, many of Mr McKenzie's concerns were easily apparent although these seemed to have been ignored by Government officials.

The Labour Government's response to this advice was somewhat muted and did not signal any substantial change of heart in the way it saw Kainga Ora operating or the future of public housing. In the Budget 2023 the Minister of Finance Grant Robertson announced changes to Kāinga Ora's debt ceiling and to how it could borrow[2] and in the 2022/23 financial year the Crown provided a further $219 million in equity. During that same year Kainga Ora's borrowing grew a further $2.6 billion so it was very much business as usual despite the organisation's warnings.

The context of Mr McKenzie's warning is considered in some detail in the analysis offered in this paper. Essentially it comes from Kāinga Ora's inadequate capital base and the ambition of the previous

[1] Kainga Ora (2022) *Update on Kainga Ora Financial Sustainability* – a briefing to the Ministers of Housing and Finance – 17 June 2022.

[2] See Treasury (2022) The Supplementary Estimates and Appropriations 2022/23 p.521

Labour led governments to turn Housing New Zealand into an urban re-development agency. This ambition was never funded and instead Kāinga Ora was expected to fund expensive urban infrastructure upgrades, particularly in Auckland, off its balance sheet or through land sales. In other words, to fund extensive re-developments and stock replacements, it was expected to privatise public land or to borrow more money. The cost of this additional borrowing as well as the additional staff to undertake the redevelopments was to come from the subsidies the Crown paid Kāinga Ora to run social housing. In his advice in June 2022, Mr McKenzie argued that this was not feasible especially given rising constructions costs and interest rates.

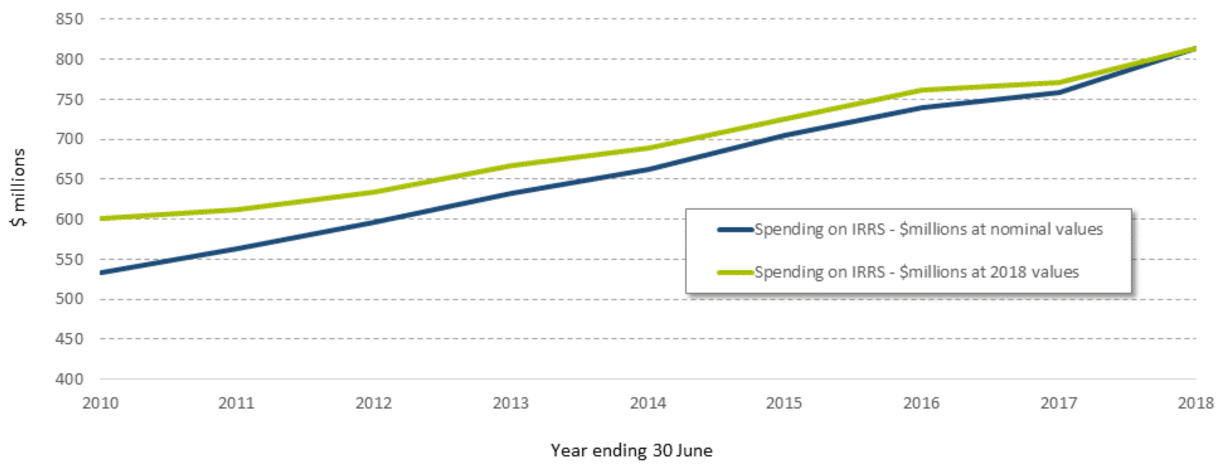
A brief history

Kāinga Ora – Homes and Communities was formed in October 2019 with the renaming and rebranding of Housing New Zealand. This change apparently 'marked the beginning of a step change in housing and urban development in New Zealand'. The newly re-named organisation had a legislative mandate to 'go beyond being a social landlord or urban development agency' so as to have 'a much larger impact on New Zealand and the quality of New Zealanders' lives' [3]. As discussed below most of this wider mandate did not come with larger budgets.

Prior to the advent of Kāinga Ora, the organisation was known as Housing New Zealand and before October 2017 and for the preceding nine years it was under the stewardship of the Fifth National Government of John Key and Bill English. During this stewardship, Housing New Zealand was moderately well supported operationally but run down in terms of its asset base. This history is shown in the following graphs for period 2008 to 2018 which includes the period (July 2010 to June 2018) over which the National led government determined Housing New Zealand's budgets and performance expectations.

Figure 1 reports spending on income related rent subsidies (IRRS) through Housing New Zealand for the period between 2010 and 2018. This data is reported in nominal and real terms (at 2018 $ values). In real terms the cost of IRRS payments rose 35% over this period from $533 million to $814 million

Figure 1: Spending in income related rent subsidies through Housing New Zealand – 2010 to 2018 [4]

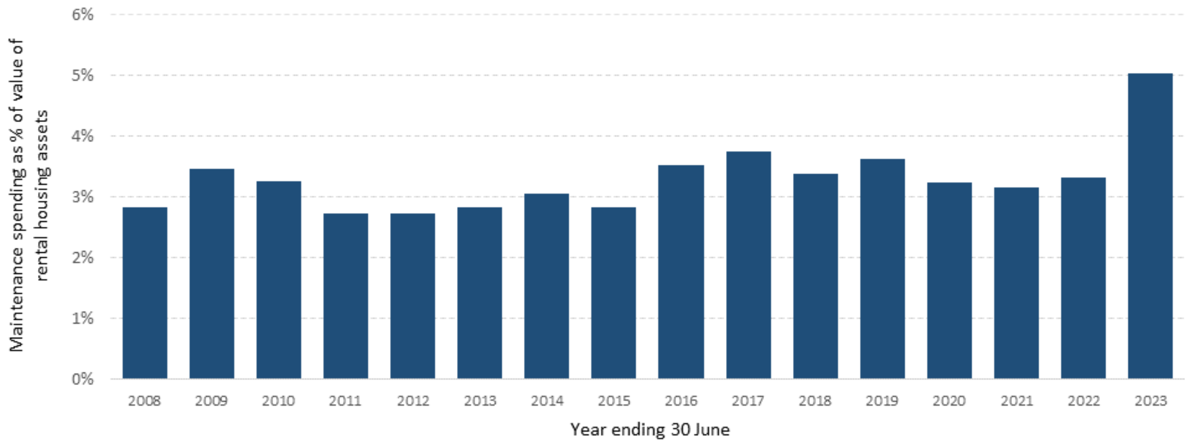


[3] Kāinga Ora website at https://kaingaora.govt.nz/en_NZ/about-us/who-we-are/

[4] Source Housing New Zealand and Kainga Ora Annual Reports

Figure 2 reports spending on repairs and maintenance on Housing New Zealand's/Kainga Ora's rental housing stock as a proportion of the value of the book value of the buildings of this stock[5]. This graph covers the 16 years between 2008 and 2023 so includes spending for the five years of management by Labour led governments. This data shows that for the nine years between July 2009 and June 2018 maintenance spending as a proportion of building value averaged 3.1%. By comparison the average during the five years of Labour's management was 3.7% although this was weighted up by the spike in spending during 2022/23. Overall spending on maintenance on the public rental housing stock was comparable between the two administrations.

Figure 2: Maintenance spending as a proportion of value of the rental housing stock – 2008-2023[6]



In June 2008 Housing New Zealand owned or leased 68,644 homes while in June 2023 Kainga Ora owned or leased just over 72,000 homes including transitional housing units. An increase of 3,400 dwellings over 16 years. Over this period New Zealand's housing stock grew by 360,000 dwellings[7] and public housing's share of this stock sunk from 4.1% to 3.5% which is close to the lowest stock share in 50 years. Figure 3 reports changes in the stock of public housing between 2008 and 2023.

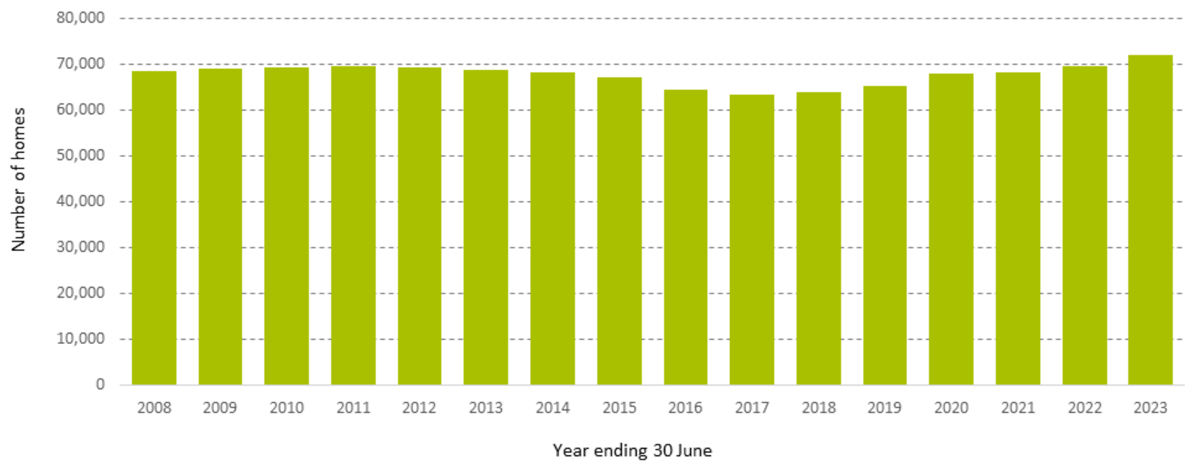
The public housing stock declined under the Fifth National Government from almost 69,500 units in June 2010 to just less than 64,000 units in June 2018. Half this decline was due to a stock transfer to the Tamaki Generation Company. This organisation remains jointly owned by the Cown and Auckland Council. A further 1,138 dwellings in Tauranga were sold in 2016 to Accessible Properties – a privately controlled community housing provider. Since June 2018, and under the stewardship of the Sixth Labour Government, the stock of housing managed by Kainga Ora grew by more than 8,000 dwellings. Almost 2,400 of these dwelling were transitional housing units.

[5] The basis of this measure is that spending on repairs and maintenance is related to the value of the buildings being maintained. While there are no agreed ratios for such spending as a proportion of building value if this ratio is falling over time there are valid concerns that the asset is being run down.

[6] Source Housing New Zealand and Kainga Ora Annual Reports

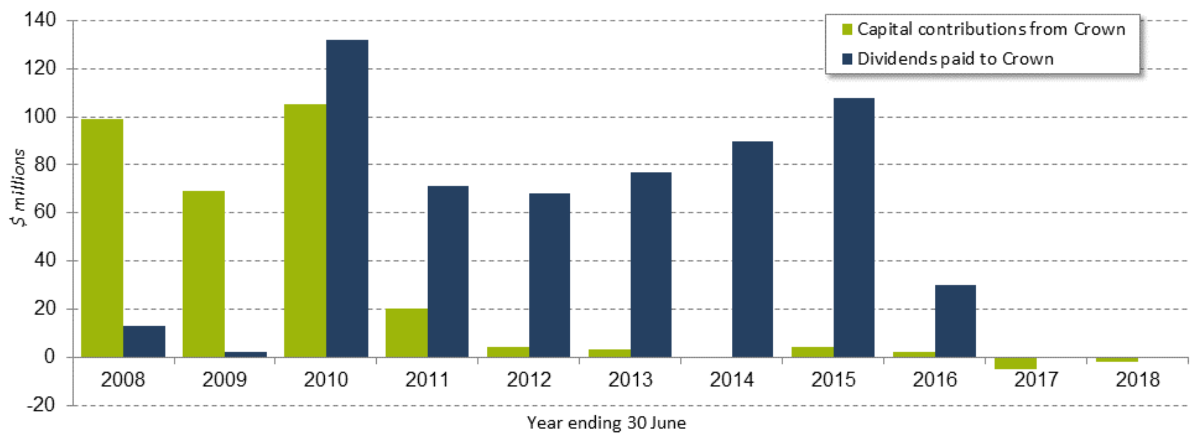
[7] Statistics New Zealand's Housing and Dwellings Estimates

Figure 3: Number of homes owned or managed by Housing New Zealand/Kāinga Ora – 2008-2023



During the time of its stewardship of Housing New Zealand, the Key-English Government drew $576 million from Housing New Zealand in dividends and contributed $131 million in additional capital. These flows are reported in Figure 4 for the period 2008 to 2018. .

Figure 4: Capital contributions to and dividend payments from Housing New Zealand - 2008 to 2018



During 2015/16 and as part of the transfer of 2,700 rental units to the Tamaki Regeneration Company the Crown withdrew $1.632 billion in capital from Housing New Zealand. This had a net effect of lowering the Crown's equity in the state-owned enterprise by $232 million. During the period of the National Government's political management of Housing New Zealand, the Crown's equity stake moved from $3.761 billion in June 2010 to $3.555 billion in June 2018. This change largely reflects the value of the Tamaki transfers.

In summary the Fifth National Government's stewardship of Housing New Zealand which ran from July 2010 to June 2018 can be characterised by the following four outcomes.

1. Operational support through income related rent subsidies grew 35% in inflation adjusted terms.
2. Spending on repairs and maintenance averaged 3.1% of the value of the rental housing stock.
3. The number of publicly owned rental housing units declined by around 2,700 units.
4. The Crown withdrew $576 million in dividends from Housing New Zealand and provided $131 million in extra equity.

Kāinga Ora's recent operating environment

Kāinga Ora – Homes and Communities was created in 2019 as a social housing landlord and an urban re-development agency. From available records, Government operational support for the urban re-development function appears to have been quite limited. Rather, the Labour Government's urban re-development ambitions were expected to be paid for by subsidies for social housing provision, borrowing by Kāinga Ora and $3 billion8 in sales of public land. None of this was explicit in the early Statements of Performance Expectations between the Government and Kāinga Ora Board [9]. The current financial position of Kāinga Ora can largely be attributed to these policy settings.

A summary of Housing New Zealand's revenue and expenditure for the six financial years prior to 30 June 2023 is presented in the table below.

Table 1: Housing New Zealand | Kāinga Ora's revenue and expenditure *($millions)*- 2018 to 2023

Year ending 30 June	2018	2019	2020	2021	2022	2023
Revenue from non-exchange transactions						
Rental revenue - Crown IRRS	814	880	959	1,044	1,128	1,151
Rental revenue - tenants - income related rents	350	368	386	390	420	469
Other revenue from Crown appropriations	94	102	103	115	107	142
Revenue from exchange transactions						
Sale of developments	0	15	58	64	166	141
Rental revenue from tenants at market rent	48	49	51	41	47	57
Lease income	0	0	0	26	46	61
Interest revenue	12	14	21	25	21	42
Other	20	23	36	18	16	9
Total operating revenue	**1,338**	**1,451**	**1,614**	**1,723**	**1,951**	**2,072**
Expenses						
Repairs and maintenance	319	366	359	418	460	630
Depreciation and amortisation	259	287	301	337	407	433
Interest expense	84	106	135	162	203	344
People costs	127	152	176	201	296	340
Rates and water rates	150	160	171	183	199	231
Cost of land sold				61	161	146
Third-party rental leases	53	51	67	71	68	73
Grants	81	84	78	80	38	63
Other expenses	112	143	206	169	228	284
Total expenses	**1,185**	**1,349**	**1,493**	**1,682**	**2,060**	**2,544**
Other gains/losses						
Loss on asset write-offs	-33	-60	-84	-86	-69	-100
Impairment of property under developement	0	0	-70	-62	-91	-15
Gain/loss on disposal of assets	5	-6	7	7	-5	-9
Total other losses	**-28**	**-66**	**-147**	**-141**	**-165**	**-124**
Operating surplus/deficit before tax	**125**	**36**	**-26**	**-100**	**-274**	**-596**

A number of elements within these results are discussed below in some detail. In summary, and over the five years of Labour's political management of Housing New Zealand | Kāinga Ora the organisation accumulated pre-tax losses of almost $1 billion ($960 million), of which two thirds ($643 million) were losses in value associated with the sell-off of Kāinga Ora property. It is difficult to know, from the available evidence, if these write downs | loss of value was on account of over-valuation of Kāinga Ora's assets or poor deals in these asset sales which gave advantage to purchasers. The available

[8] In 2020 a four appropriation of $271 million through the Infrastructures Investment to Progress Urban Development (M37)(A22) budget was provided 'enable urban development, regeneration and housing outcomes'. Litle of this spend appears in Kainga Ora's 'Other revenue from Crown Appropriation' receipts which mainly paid for KiwiBuild and first homeownership support related subsidies

[9] Briefing to Incoming Minister 2023 p.41

evidence points to the former. Most of the remaining accumulated losses – not associated with write-downs, came about from an operational loss of $472 million in the 2022/23 financial year. Superficially this single year loss was due to expenses growing faster the revenue. In particular revenue from income related rent subsidies grew 2% while expenses increased 23%. These subsidies make up more than half (56%) of Kāinga Ora's operating revenue. While this mismatch is due partly to cost pressures in Kāinga Ora's operations (these are considered later in the paper), the misalignment between the value of income related rent subsidies and the inflationary pressures faced by Kāinga Ora as a business are a particular weakness in the organisation's operating model.

Figure 5 below charts movements in various price/cost indicators against movements in the value of the total income related rent subsidies received annually by Kāinga Ora. Figure 6 considers the inflation adjusted value of income related rents expressed as an average payment for very residential unit managed by Kāinga Ora at the time of the subsidy. Both graphs illustrate this mismatch and perhaps that the income related rent subsidy is mainly an administrative number not much related to the foregone market rents it is supposed to be based on.

Figure 5: A comparison of price/cost indicators and income related rent subsidies – 2018 to 2023

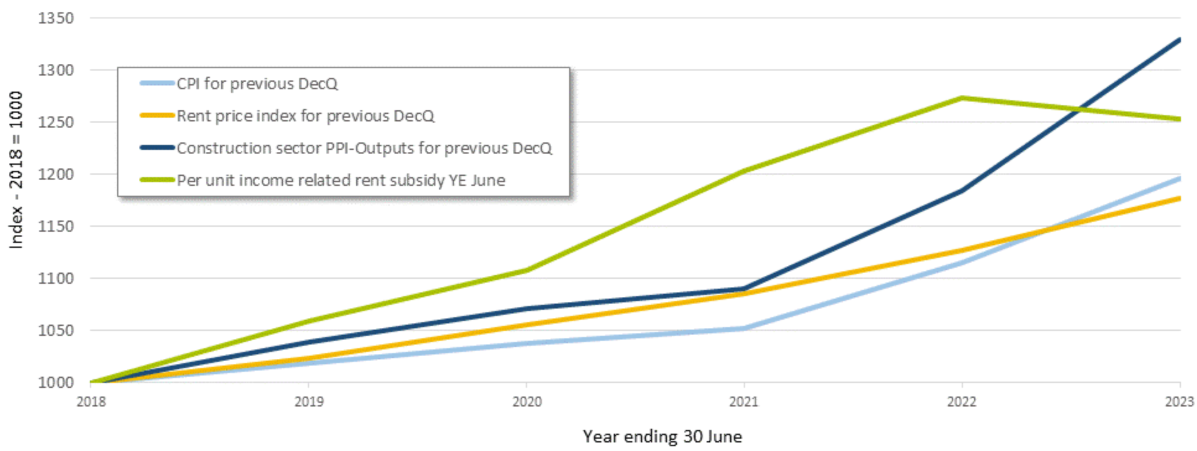
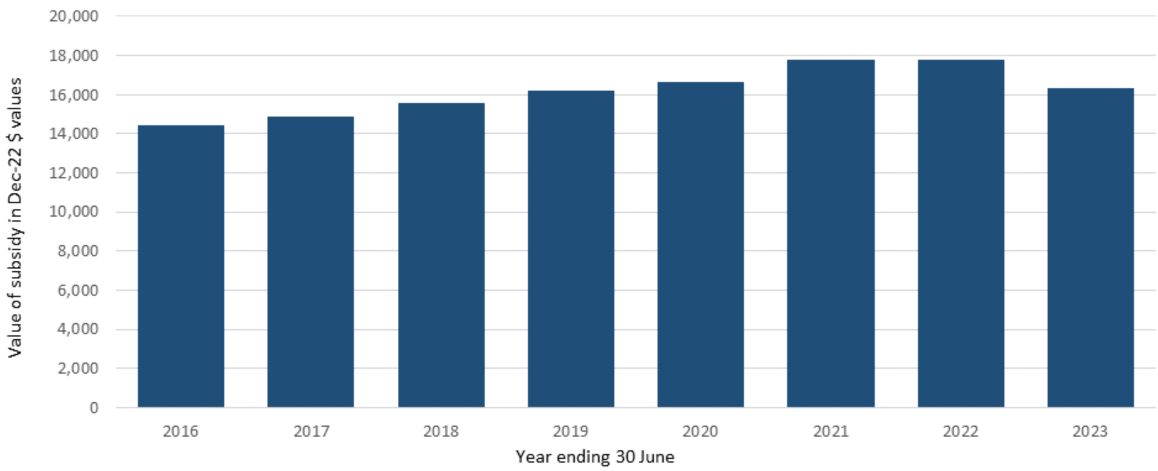


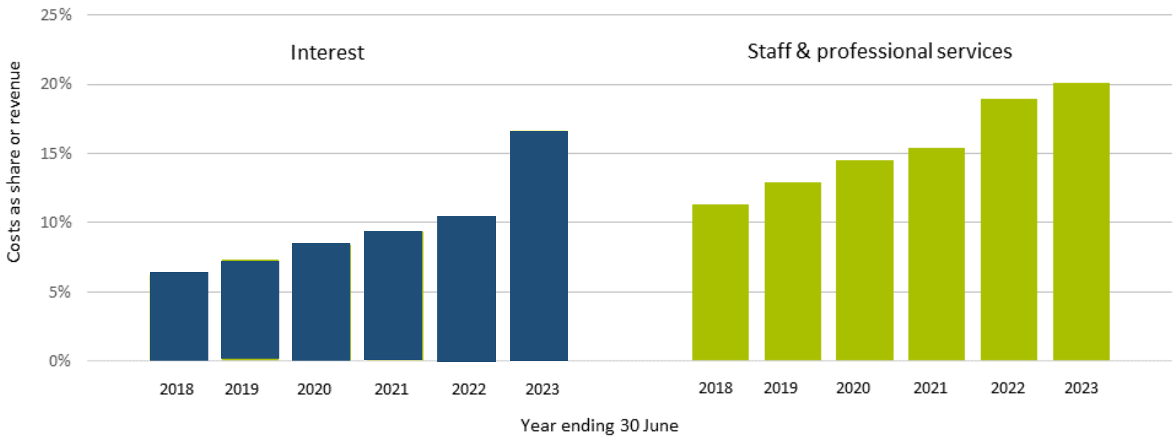
Figure 6: Inflation adjusted value of per home income related rent subsidy – 2016 to 2023.



The data offered in figures 5 and 6 show that the value of income related rent subsidies (on a per unit basis) were generous initially but that that generousity slipped away in 2022/23. In inflation adjusted terms the per unit value of the income related rent subsidy in 2022/23 was less than in 2018/19.

However, Kāinga Ora's financial position is not solely the result of a diminution of income related rent subsidies. Between 2018 and 2023 its operating costs increased 115% against a headline inflation rate of approximately 20%. These increases were related to the increased scale of the business and increased debt servicing costs on account of higher debt and interest rates. Put succinctly, Kāinga Ora did more and owed more in 2023 than it did in 2018. This change is somewhat shown on the following graph which charts interest costs and the costs of staff and professional services as a share of revenue from 2018 to 2023. During the 2017/18 financial year these two areas of cost amounted to 16.4% of Kāinga Ora's revenue and by 2022/23 these costs had risen to 36.7%. Maintenance costs also increased relative to revenue from less than 24% in 2017/18 to more than 30% in 2022/23.

Figure 7: Costs of interest and staff and professional services as share of revenue – 2018 to 2023



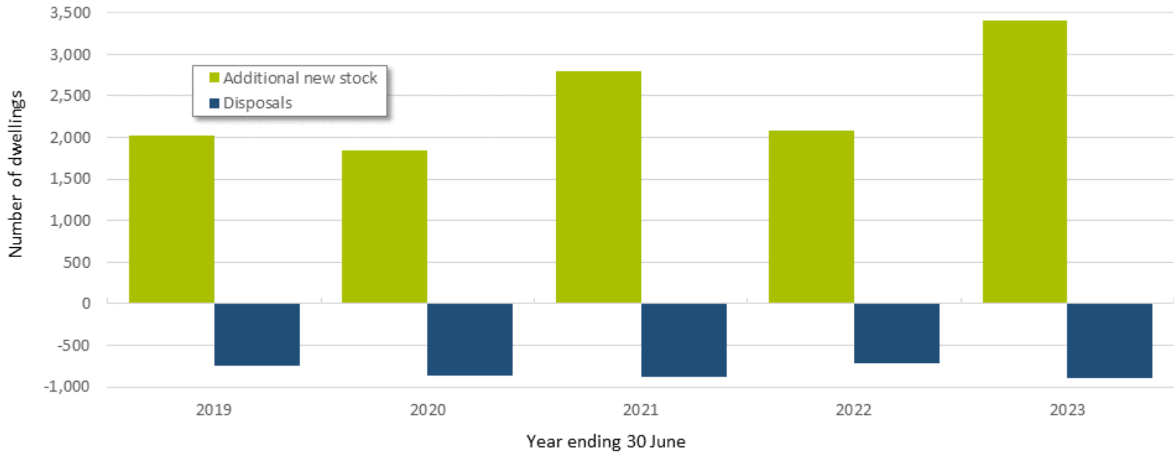
Kāinga Ora's increased debt burden is considered later in this paper. The organisation's increased scale is partly illustrated in Figure 3 above which shows changes in the stock of dwellings under Kāinga Ora's management. This stock increased from 64,000 in June 2018 to 72,000 in June 2023. What isn't apparent from that data is the scale of the increased effort to build this additional housing on a stock which was aging and sometimes poorly maintained. This increased effort may account for some of the ballooning costs of staff and professional services shown in Figure 7.

In December 2023 Kāinga Ora claimed that it had 6,300 dwellings under development or under contract, and that it had 'built internal and supplier capability and capacity to deliver over 5,000 home construction builds and retrofits (substantial renovations) a year'.[10] For an organisation which has only once built or acquired more than 3,000 new dwellings in a year and has consistently failed to reach is build or acquisition targets[11], these claims need to be anticipated with caution. There is however encouraging evidence that Kāinga Ora has gradually built its capacity to develop and re-develop at scale as shown in the following graph which reports numbers of additional stock built or acquired by Kāinga Ora between 2019 and 2023. These numbers, especially those for 2021/22, need to be seen against the background of the supply chain disruptions during and following the Covid-19 lockdowns.

[10] Briefing to Incoming Minister – 2023, p.5.

[11] For example Kāinga Ora's 2021/22 Statement Service Performance promised an additional 2,700 dwellings under its management for the 2021/22 of which 1,600 would be rental housing units and 1,100 supported housing units (p.39). Kāinga Ora's Annual Report 2021/22 reported delivery of 566 rental housing units and 667 supported housing units (p.56)

Figure 8: Additional dwellings and disposals of Kainga Ora's managed stock – 2019 to 2023



Kāinga Ora's balance sheet and cash flow

The increased scale of Kāinga Ora's business has been financed from its balance sheet and facilitated by its cash flow rather than from increased revenue or additional equity capital. This is shown in the following two tables which respectively report, summarily, the organisation's cash flows and financial position from 2018 to 2023.

Table 2: Housing New Zealand's | Kainga Ora's cash flow statements *($millions)*- 2018 to 2023[12]

Year ending 30 June	2018	2019	2020	2021	2022	2023
Cash flows from (used in) operating activities						
Rent receipts IRRS	813	880	963	999	1128	1151
Rent receipts tenant	391	410	398	426	483	526
Other Crown appropriations	108	115	113	128	118	149
Sales of developments			48	64	63	142
Land development activities					-184	-21
Other receipts	38	47	32	29	51	63
Payments to suppliers and employees	-797	-992	-1093	-1125	-1273	-1633
Interest (net)	-72	-89	-114	-137	-178	-189
Cost of goods sold			-59	-63		
Income tax paid	-121	-77	-104	-90	-88	-24
Net cash flow from (used in) operating activities	**360**	**294**	**184**	**231**	**120**	**164**
Cash flows from (used in) investing activities						
Purchase of rental property assets	-946	-1523	-1461	-1887	-2216	-3502
Net short-term investments	324	116	-1410	281	-111	507
Other cash flows	32	3	-97	-4	-17	-32
Net cash flow from (used in) investing activities	**-590**	**-1404**	**-2968**	**-1610**	**-2344**	**-3027**
Cash flows from (used in) financing activities						
Net contribution from (to) Crown	-2	-1	6	3	-2	219
Market notes issued	700	851	2903	1188	-1	-136
Crown debt drawn down	-1	33			2168	2645
Net cash flow from (used in) financing activities	697	883	2909	1191	2165	2728
Net cash flow	**467**	**-227**	**125**	**-188**	**-59**	**-135**
Cash reserves at 30 June	**523**	**296**	**421**	**233**	**174**	**39**

[12] Source: Housing New Zealand's and Kainga Ora's Annual Report for the years 2017/18 to 2022/23

Table 3: Housing New Zealand's | Kainga Ora's financial position *($millions)*- 2018 to 2023[13]

Year ending 30 June	2018	2019	2020	2021	2022	2023
Assets						
Cash and cash equivalents	523	296	421	233	174	39
Investments	148	35	1,296	1,136	1,199	741
NZ Government Bonds	0	0	200	50	98	49
Interest rate derivatives	1	0	0	29	5	8
Receivables and prepayments	44	31	84	165	350	395
Properties held for sale	5	27	14	45	44	19
Properties under development	55	144	191	365	504	525
Other Assets	69	53	43	45	37	36
Property plant and equipment	26,645	28,410	30,685	38,868	46,433	43,264
Freehold land	16,771	17,420	18,363	23,537	29,908	26,473
Rental properties	9,446	10,087	11,058	13,257	13,834	12,536
Other assets	472	880	1,215	2,074	2,691	4,255
Total assets	27,490	28,996	32,934	40,936	48,844	45,076
Liabilities						
Accounts payable and other liabilities	168	218	168	280	421	582
Income tax payable (receivable)	5	17	28	22	-6	-48
Mortgage Insurance Scheme	32	32	31	30	25	51
Interest rate derivatives	94	114	114	58	22	23
Borrowings - Crown	1,953	1,986	1,985	1,985	1,985	4,630
Borrowing - Market debt	700	1,550	4,454	5,642	7,809	7,673
Deferred tax liability	2,206	2,141	2,192	2,570	2,510	1,819
Other and miscellaneous liabilities	13	14	20			
Total liabilities	5,171	6,072	8,992	10,587	12,766	14,730
Net assets	22,319	22,924	23,942	30,349	36,078	30,346
Equity						
Equity attributable to the Crown	3,555	3,555	3,561	3,564	3,562	3,781
Retained earnings	596	712	697	904	779	403
Revaluation reserve	18,234	18,739	19,793	25,923	31,741	26,157
Hedging reserve	-66	-82	-81	-42	-4	5
Total equity	22,319	22,924	23,970	30,349	36,078	30,346

The story to take out of Table 2 is that of debt and capital spending on rental housing over the period 2019 to 2023. This story is summarised in the following table which considers total cash flow for the whole five-year period to illustrate how Kainga Ora worked in cash flow terms during this period.

Table 4: Summary of Kāinga Ora's total cash flows – 2019 to 2023

	$billions			$billions
Cash flows from operations			**Headline cash flows**	
IRRS receipts from Crown	5.1		Purchase of rental property assets	-10.6
Other appropriations from Crown	0.6		Increase in debt	9.0
less income tax paid	-0.4		Contribution from operating activities	1.0
Net cash from Crown	5.4		Capital contributions from Crown	0.2
			Decline in cash reserves	-0.5
Rent from tenants	2.2		Other cash flows	-0.8
Net proceeds from property sales	0.0			
Net interest	-0.7			
Payments to suppliers and employees	-6.1			
Other receipts	0.2			
Net cash flow from operations	1.0			

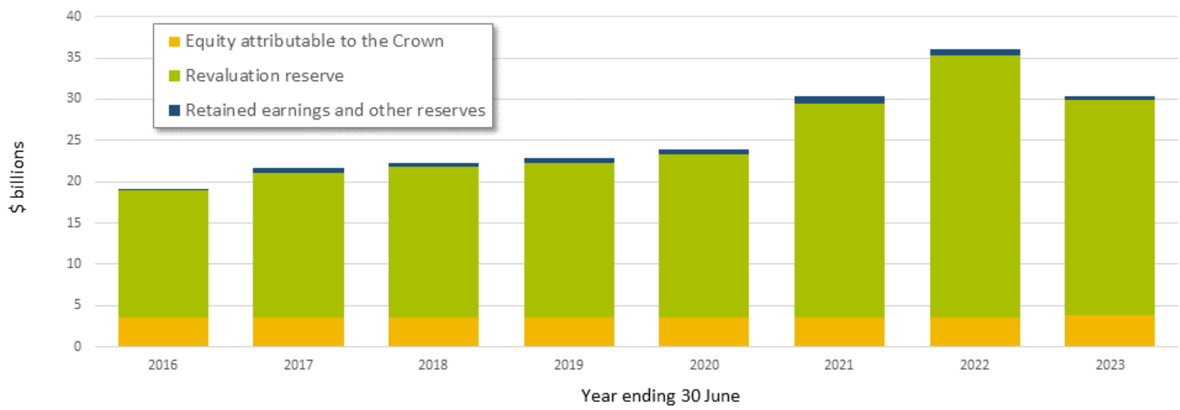
[13] Source: Housing New Zealand's and Kāinga Ora's Annual Report for the years 2017/18 to 2022/23

The $10.6 billion reported to have been spent in Kāinga Ora between 2019 and 2023 supports the argument offered above that the organisation has scaled up significantly over this period and that this has contributed to rising operating costs and a changing cost structure. Table 4 shows clearly too that this building and maintenance effort is related to increasing debt. This $10.6 billion five years spend under the previous Labour Government is four times more than the same category of spending under the prior National Government when $2.6 billion was spent over the five years between 2014 and 2018.

While this $10.6 billion of spending is categorised as investment spending on the 'Purchase of rental property assets', it is by no means clear what was purchased. Some of this expenditure is most likely to be spent on maintenance rather than additional housing stock. In its December 2023 Briefing to the Income Minister Kāinga Ora reported that it classified approximately one third[14] of its spending on repairs and maintenance as capital spending – presumably because it extended the life of the assets being maintained. Not all of this capital spending on rental property assets resulted in more housing.

Table 3 shows that Kāinga Ora's equity position improved substantially between 2020 and 2022 but subsequently fell during 2022/23. These movements were almost entirely due to changes in the assessed value of Kainga Ora's rental housing assets as shown in Figure 9. Between June 2020 and June 2022 Kainga Ora's property assets were estimated to have risen more than 50% and by $16.6 billion. Nearly 60% of this increase was due to higher land values which rose almost $10 billion (or 63%) in two years. Land values subsequently fell precipitously during 2022/23 by $3.4 billion to account for almost the entire right-down of property asset values in that year.

Figure 9: Housing New Zealand's |Kāinga Ora's equity position – 2016 to 2023



These changing values of land and buildings are due to a number of factors including additions and disposals of assets, reclassification of assets as they are prepared for sale or re-development, and revaluations which reflect price changes in regional residential property markets. Table 6 below strips out the impact of revaluations on these values for freehold land and rental housing for the six years to 30 June 2023. The year-by-year changes in these values are compared with the same time changes in the Reserve Banks Housing Price Index. The two value indicators are comparable suggesting that the apparently volatile revaluations of Kainga Ora's properties have been a sound reflection of market conditions.

[14] Briefing to Incoming Minister 2023 p.18.

Table 5: Analysis of Housing New Zealand's | Kāinga Ora's property revaluations – 2018 to 2023[15]

Year ending 30 June	2018	2019	2020	2021	2022	2023
Freehold land						
Opening value - 1st July (previous year)	16,303	16,771	17,420	18,363	23,576	29,908
Revaluations	195	326	813	5,307	6,124	-3,740
Other adjustments	273	323	130	-94	208	305
Closing value 30 June	16,771	17,420	18,363	23,576	29,908	26,473
Rental properties						
Opening value - 1st July (previous year)	8,426	9,446	10,177	11,184	13,470	14,052
Revaluations	452	57	142	1,300	-445	-2,345
Other adjustments	568	674	865	986	1,027	1,111
Closing value	9,446	10,177	11,184	13,470	14,052	12,818
Land and buildings						
Opening value - 1st July (previous year)	24,729	26,217	27,597	29,547	37,046	43,960
Revaluations	647	383	955	6,607	5,679	-6,085
Other adjustments	841	997	995	892	1,235	1,416
Closing value	26,217	27,597	29,547	37,046	43,960	39,291
Annual increase due to revaluations	2.6%	1.5%	3.5%	22.4%	15.3%	-13.8%
Annual change in Reserve Bank House Price Index	3.6%	1.5%	7.1%	29.6%	5.3%	-9.0%

There are a few reasons to question if the estimated value of Kāinga Ora's rental property assets is a realistic reflection of the realisable value of these properties. The value of this property portfolio is assessed annually by an independent professional valuer based on accepted valuation techniques. The resulting values are said to reflect market values for the properties within this portfolio[16].

The realism of this approach is, however, questionable notwithstanding its orthodoxy. The portfolio is owned for social rather than market purposes- that is the provision of affordable rental housing which is heavily subsidised by the State. While it is perfectly legitimate to sell off small parts of the portfolio on an incremental basis- as the prior National Government did between 2010 and 2018, the complete privatisation of the public housing stock is not politically feasible and would on any account severely disrupt property markets if it was attempted. Some of the portfolio is already encumbered by Treaty settlement obligations which require some properties to be offered for sale to iwi/hapu on a right of first refusal basis[17].

These limitations may explain why the book values of Kāinga Ora properties identified for sale were written done prior to sale. These write downs are reported in Table 6 for the five years 2019 to 2023. Over this period $1.7 billion of Kāinga Ora property was re-classified as property for development[18] and was written down by $244 million, or 14%, to reflect its realisable value. Why wouldn't similar levels of discount not apply to the whole of Kainga Ora's property portfolio?

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[15] Sources: Housing NZ and Kāinga Ora Annual Reports – notes to Financial Accounts and Reserve Bank date series Housing M10.

[16] See for example an explanation of this valuation paraments at Note 2 and Note 11 on p. 188 and p.207 of Kainga Ora's 2022/23 Annual Report.

[17] See for example Kāinga Ora's Annual Report 2022/23 p.207.

[18] It is not clear why this development is occurring although it is probably related to the partial sell-off of land within suburban re-development programmes which are said to 'enabling' this land for the development of 'affordable' and market housing.

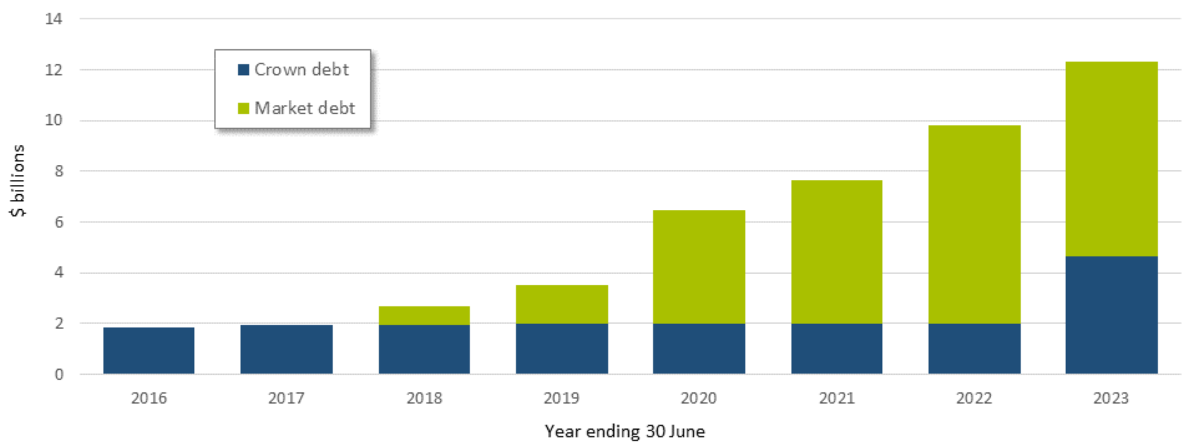
Table 6: Write downs of Kāinga Ora's property values – 2019 to 2023[19]

Year ending 30 June	2019	2020	2021	2022	2023	Total for 5 years
Properties under development	144	191	365	504	525	1729
Write downs to net relisable value		70	68	91	15	244
Write down as proportion of value		37%	19%	18%	3%	14%

These quibbles over property valuations surely don't really matter if the properties concerned are unlikely to be sold? They are however relevant if future reference is made to the market-based opportunity costs of the current uses of Kāinga Ora's assets or if mention is made to market focused indicators of the organisation's financial health. Lower realisable values make these opportunity costs lower and the financial indicators worse.

The other side of Kāinga Ora's balance sheet is its debt. The history of this debt is reported in Figure 10. It shows two recent phases in Kainga Ora's borrowing. The first is from 2019 to 2022 with the rapid increase in overall debt – all of which was borrowed from the market. Over this period the organisation's borrowing grew by 177% or $6.3 billion to $9.8 billion. As seen above, this debt was used to finance Kainga Ora's asset development and re-development programmes. By June 2023 Kainga Ora's borrowings stood at $12.3 billion an increase of $9.7 billion over the five years of Labour's political management. The most noticeable tangible achievement from this borrowing was the expansion of Kainga Ora's housing stock by 8,000 homes to 72,000 in June 2023. Other less noticeable achievements included the increased spending on property maintenance and preparation of urban land for re-development.

Figure 10: Housing New Zealand's | Kāinga Ora's borrowings – 2016 to 2023[20]



The second phase of Kainga Ora's debt story was the sudden switch in 2022 to using Crown debt rather than borrowing directly from private debt markets. In 2022 the Government started lending more to its subsidiary after more than a decade of a resolutely stable Crown debt ceiling of $1.9 billion. In that year the Government increased its lending to Kāinga Ora to $4.6 billion.

It is difficult to understand why the Labour Government insisted that Kāinga Ora borrow from the market in the first place. Generally, the Government, through the Crown Debt Management Office,

[19] Sources: Kāinga Ora Annual Reports – notes to Financial Accounts - 2019/20 at p.120, 20/21 at p.178 and 22/23 at p.202.

[20] Sources: Housing New Zealand's and Kāinga Ora Annual Reports - Statements of Financial Position.

would be more efficient at borrowing money from private markets than would Kainga Ora. These private markets may also attach a small risk premium in lending to Kainga Ora although such lending is for all intents and purposes Government guaranteed.[21]

The evidence to support or refute the wisdom of Kainga Ora borrowing directly from the market is mixed. Data on such borrowing and the interest rates paid is reported in Table 7 for the period 2016 to 2023. These interest rates are compared with a 5-year Government bond yield as an indicator of the current opportunity costs of such borrowing.

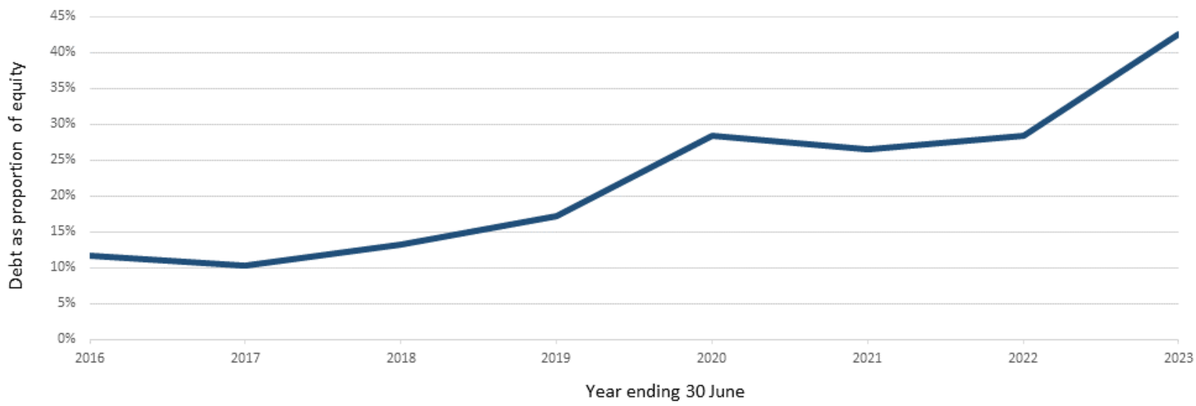
Table 7: Housing New Zealand's | Kāinga Ora's borrowings and interest rates- 2016 to 2023[22]

Year ending 30 June	2016	2017	2018	2019	2020	2021	2022	2023
Crown debt $ millions	1,859	1,953	1,953	1,986	1,985	1,985	1,985	5,481
Weighted average interest rate	2.25%	2.32%	2.01%	1.65%	0.39%	0.44%	2.57%	4.47%
Market debt $ millions			700	1,550	4,454	5,450	7,670	6,800
Weighted average interest rate			2.86%	2.65%	1.97%	1.93%	2.43%	2.46%
Secondary market 5 year bond yields- at June	2.12%	2.46%	2.28%	1.30%	0.43%	1.03%	3.77%	4.44%

Between 2018 to 2021 there was a positive margin between market and Crown sourced debt although this reversed in 2022 and 2023. Much of the difference during this latter period would be on account of the maturity terms of the market debt. On any account Kāinga Ora's further borrowing of $2.6 billion over 2022/23 would have attracted an interest rate around 4.5% to 5% regardless of its source.

A summary indicator of Kāinga Ora's financial position is the debt-to-equity ratio which is reported in Figure 11 for the period 2016 to 2023. This data shows a rapid deterioration in this indicator between 2021/22 and 2022/23 rising from 28% to 43%. This change was on account of the combined effects of falling asset values and rising debt. The relevance of this indicator for a publicly owned and supported organisation such as Kāinga Ora needs to be questioned although it may be used by some critics to raise concerns about the financial wellbeing of the organisation.

Figure 11: Housing New Zealand's | Kāinga Ora's debt to equity ratio – 2016 to 2023



[22] Sources: Kāinga Ora Annual Reports – notes to Financial Accounts-The weight average interest rate for market debt is the weighted average interest rate across reported market paper and medium term notes. Data on the Secondary Market 5 year bond yield is sourced from the Reserve Bank's financial data series B2

Conclusions

Within the context of recent history, the transformation of Housing New Zealand into Kāinga Ora is somewhat exceptional on at least two counts.

For the first time, perhaps since the 1970s, the State has become involved in a hands-on way, in urban development and re-development. This involvement was probably overdue on account of the run-down condition of many of the 'state-house suburbs' where Housing New Zealand and now Kāinga Ora have dominant ownership. In addition, population pressure – especially in Auckland, has created social and economic demand for better utilization of these land holdings – at least in terms of higher densities and greater connectivity.

The housing stock of Housing New Zealand and now Kāinga Ora has been allowed to physically deteriorate through inadequate maintenance budgets and lack of any comprehensive interest in renewals. This has been a failure of successive governments at least since the mid-1970s – that is until now. The efforts by Kāinga Ora and the former Labour Government to address this long-running deficit have been commendable although probably still only barely adequate. The challenge to continue this work has been laid clearly and squarely at the feet of the current Minister of Housing in Kāinga Ora's briefing papers.

The wisdom of combining a public housing landlord with a national scale urban re-development agency has not really been questioned. There are conflicts in these roles, not the least of which is the obvious drift toward Kāinga Ora leading state sponsored gentrification of former state house suburbs such as Northcote, Mt Roskill, Mangere and Naenae. This is played out in the politically directed emphasis on enabling private development on public land in these suburbs[23] .

The value of this market-focused development activity needs to be explained by those promoting it. It is not apparent that this activity has done any better than breakeven. The State (through Kāinga Ora) has been busy re-developing public land to facilitate private development and investment just for the sake of it. This effort does not appear to have benefited tenants and would-be tenants of Kāinga Ora and it does not appear to have generated a profit for Kāinga Ora or taxpayers.

The cost of doing all this needs to be considered. Kāinga Ora borrowed almost $10 billion between 2019 and 2023 and has provided 8,000 extra state housing units. In addition, it has begun to address the serial neglect of poor maintenance and minimal renewals and has from all accounts built a capacity to scale up its house building and urban redevelopment activities. These are hard won gains against a legacy of confusion and indifference from previous administrations.

The fact of an extra $10 billion debt on Kāinga Ora's balance sheet is simply a reflection of how the previous Government chose to fund the capital requirements of its public housing and urban development agency. In whole-of-government opportunity cost terms it makes little difference if these capital requirements are funded as equity or debt. However, from Kāinga Ora's perspective, needing to fund the previous Government's urban re-development ambitions from debt and against social housing subsidies appears to have become unsustainable. This position has arisen because the agency has been starved of equity capital.

Urban re-development is a costly and fraught activity in which the Government has until recently had no experience. There are often significant and unforeseen costs especially around infrastructure replacement, land contamination and geotechnical issues with building at scale. These often end up as sunk costs. Suggestions that these costs are funded as debt which one day will be recovered from future income streams have not been proven. This in particular is the challenge faced by Kāinga Ora as it also tries to meet its other challenge of housing some of the poorest and most vulnerable New Zealanders.

While the previous Labour Government was ambitious in its transformation of Kāinga Ora and the breadth of the organisation's mandate, it really lacked a matching ambition to pay for it. That Government used social housing budgets to drive urban redevelopment and only lately came to the realisation that this was inadequate. The Infrastructure Acceleration Fund is an example of this realisation and regrettably it lacked any considered connection to what is required to address New Zealand's numerous infrastructure deficits. It appears to be little more than a band aid.

A great deal will be lost if Kāinga Ora as a public housing and urban development agency is dismantled. For the first time since at least the 1970s New Zealand has a public agency which can build cities, towns and the physical dimensions of communities. The initial results in terms of redevelopments provided by Kāinga Ora are encouraging in terms of the quality and fitness for purpose. It is important to maintain this progress in the face of burgeoning unmet housing need and urban infrastructure deficits.

Whether or not Kāinga Ora should retain its dual function as an urban re-development agency and public housing landlord should be debated more thoroughly than when Kainga Ora was established on a political whim. While the two roles have some synergies, they also have some conflicts and potentially confused agendas. A central government agency running local urban re-development projects is a top-down approach which does not appear to have paid much regard to the local and regional interests of councils, manawhenua and communities. Some thought should be given to the establishment of genuine partnerships between Government, local councils, iwi/hapū and local communities in the re-building of state housing suburbs and public housing stock which should remain in them.