MINISTRY OF BUSINESS,
INNOVATION & EMPLOYMENT
HĪKINA WHAKATUTUKI

AIDE MEMOIRE

Impact of KiwiBuild on residential investment forecasts

Date:	15 May 2018	**Priority:**	High
Security Classification:	**Unclassified**	**Tracker number:**	3404 17-18

Information for Minister(s)	
Hon Phil Twyford Minister of Housing & Urban Development	

Contact for telephone discussion (if required)				
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The following departments/agencies have been consulted					
☐ Treasury	☐ MoJ	☐ NZTE	☐ MSD	☐ TEC	☐ MoE
☐ MFAT	☐ MPI	☐ MfE	☐ DIA	☐ TPK	☐ MoH
		☐ Other:	N/A		

Minister's office to complete:

☐ Approved ☐ Declined
☐ Noted ☐ Needs change
☐ Seen ☐ Overtaken by Events
☐ See Minister's Notes ☐ Withdrawn

Comments:

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[Remove the MAKO number]

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Purpose

Below, we provide advice on the additional residential investment that can be expected as a result of KiwiBuild.

Jo Doyle
General Manager, Housing & Urban Branch
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Ministry of Business, Innovation and Employment
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Budget economic and fiscal update

1. As part of Thursday's Budget, Treasury will publish its budget economic and fiscal update (BEFU), which includes economic forecasts out to June 2022. One of these forecasts is the value of investment in residential construction, which Treasury uses as an input to its forecasts for tax revenue.
2. You have received advice from Treasury that describes its latest assumptions regarding the impact that KiwiBuild will have on the residential investment forecast in BEFU. Treasury is forecasting that around $2.5 billion of additional residential investment will occur in the period to June 2022, half of what it was forecasting six months ago (HYEFU).
3. Treasury assumes that KiwiBuild will support a similar amount of investment overall as it was assuming six months ago, but that changes to when the Government will spend its capital have shifted the investment profile out. In short, Treasury is still assuming that a further $2.5 billion will still be invested, but not until after June 2022.
4. Below, we compare Treasury's forecasts with the range of residential investment that MBIE estimated in its advice to Treasury, noting that our estimates did not discount for capacity constraints or substitution:

Estimated residential investment	2018/19	2019/20	2020/21	2021/22	Total 2018-22
HYEFU	$24m	$720m	$2,069m	$2,620m	$5,441
BEFU	$0m	$323m	$841m	$1,387m	$2,551m
MBIE (no substitution / constraints)	$430m	$1.1 - $2.1b	$1.6 - $4.1b	$1.6 - $4.9b	$4.8 - $11.6b

Spending timetable

5. The reason Treasury based its BEFU forecast on a longer investment timeframe than it was assuming six months ago is because of the indicative impact on net debt that Cabinet noted when it decided the appropriations for KiwiBuild in April [CAB-18-MIN-0142]. Six months ago, Treasury assumed that the $2 billion the Government was budgeting for KiwiBuild would be spent in two equal halves over the next two years (and then recycled thereafter). In contrast, Cabinet has now noted an indicative timetable in which the impact on net debt would ramp up to $2 billion over three years, rather than two.

Issues with Treasury's assumptions

6. Treasury makes three assumptions:
   a. first, that the indicative timetable Cabinet has noted is a timetable of capital expenditure;
   b. secondly, that capital expenditure precedes residential investment (meaning there is a delay between the two); and
   c. thirdly, that only the KiwiBuild component of developments count as additional residential investment.
7. In fact, Cabinet has approved a multi-year appropriation for KiwiBuild, which means that the $2 billion can be spent as fast as projects can be found to invest in. Thus, the timetable Cabinet has noted is not a timetable of capital expenditure. It is a timetable of resulting net debt. Concealed within the expected impact on net debt at the end of any one financial year is higher expenditure during the year that is offset by income from sales.
8. Secondly, during the first four years of KiwiBuild, we expect that the Buying Off the Plans programme will be the delivery method through which the majority of KiwiBuild homes are sourced. In the case of this programme, the majority of expenditure will <u>follow</u> residential investment, rather than precede it, meaning there will be no delay.
9. Thirdly, only counting KiwiBuild homes ignores the greater residential investment that KiwiBuild will drive in non-KiwiBuild homes.

Net effect of operating expenses and sales revenue

10. Cabinet has noted that the expected impact on net debt will be $210 million in the 2018-19 financial year under a new output expense appropriation for KiwiBuild housing [CAB-18-MIN-0142]. This is an indicative estimate of net operating expenditure for the Buying Off the Plans programme at the end of its first year.
11. As a net figure, it conceals the potential to spend $500 million on purchasing new homes and then on-selling more than half of them before the end of the year. In this scenario, the actual expenditure would be $500 million, offset by revenue of $290 million, for net operating expenses of $210 million at year's end. The $500 million is the expenditure that impacts residential investment, not the net operating expense of $210 million.
12. The indicative expenses are also misleading because of the accounting treatment that underpinned the timetable that Cabinet noted. Although cash flows out when the Crown first purchases the house, for accounting purposes the expense is not incurred until the house is on-sold. In the meantime it is simply treated as inventory.

Residential investment before expenditure

13. Buying off the plans enables the Crown to induce high levels of residential investment from low levels of initial expenditure. If committing to actually purchase the house, the Crown can

expect to pay a 10% deposit up front and then not have to pay the other 90% until the home is completed. In between, the developer actually builds the new homes. Thus, a 10% deposit is enough to induce 100% of the residential investment required to construct a home before the other 90% of the purchase price is required.

14. Alternatively, the Crown can guarantee to purchase a new home if the developer is unable to sell it. In this case, the Crown pays nothing up front, but its guarantee still induces 100% of the residential investment for the guaranteed homes. Even if the Crown needs to incur an expense against the chance that the guarantee will be triggered, when spread across the total portfolio of homes under guarantee, this provision is likely to be a relatively low proportion of total value (e.g. 10-20%). Again, therefore, low expenses induce high residential investment.
15. As above, assume targeted expenditure of $500 million for the first year of KiwiBuild, with $100 million allocated to the guarantee and the other $400 million to actual purchases. If we budget for the Crown to have to purchase 20% of the homes it guarantees, a budget of $100 million underwrites $500 million of KiwiBuild housing. Add that to the $400 million of actual purchases and the result is $900 million worth of housing in the first year.
16. If we then assume that before the end of the year the Crown on-sells $290 million of the homes it actually buys, the result is that the $210 million of net operating expenses that Cabinet has noted can actually conceal total sales of $900 million. If we roughly assume that the value of the land is 40% of that total, it suggests total residential investment of $540 million.

Leveraging investment in non-KiwiBuild homes

17. If the Crown underwrites 40% of a development for KiwiBuild, it not only accelerates the delivery of the KiwiBuild homes, it also accelerates the delivery of the non-KiwiBuild homes. Assuming the KiwiBuild homes are 40% of the total number of houses in each development, $900 million of KiwiBuild housing will be part of over $2 billion of total housing, suggesting over $1 billion of residential investment.

Is it additional investment?

18. If the Crown is purchasing or guaranteeing homes in developments that the private sector was going to deliver anyway, then the development itself is not additional. If the same value of housing is delivered within that development then the development's residential investment is not additional overall.
19. However, the key is timing. Consider a development that will take a year to sell off the plans and then a further year to build. The day it goes on sale, the Crown commits to buying half of the homes. On the strength of that commitment, the bank releases the finance and the whole development is built a year earlier. In this case, 100% of the residential investment is additional to the current year, because without KiwiBuild none of that investment would have occurred until the following year.
20. Thus, the extent to which the investment is additional depends on how long it would have taken for development to occur absent the Crown's involvement.

Conclusion

21. In light of the considerations above, and informed by the investment range we provided, we considered that Treasury's forecasts in HYEFU remained more accurate and so recommended to Treasury that they be retained.