Information has been redacted from this report for the following reasons: Making the information available is likely unreasonably to prejudice the commercial position of the person who supplied it or who is the subject of the information; to enable Council to carry on negotiations without prejudice or disadvantage. (Sections 7(2)(b)(ii), 7(2)(i) of the Local Government Information and Meetings Act 1987)

Nelson City Council Community Housing Options

6 November 2017

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1. Executive Summary

Nelson City Council's (Council) community housing comprises 142 units in nine complexes providing bedsits, single and double bedroom units for older persons only.

The portfolio is around 40 years old and will need significant maintenance over the next 5 to 10 years.

50% of the portfolio will require renewal within 25 years at a cost estimated at about $20 million (in 2017 dollars).

The portfolio is currently managed by Nelson Tasman Housing Trust (NTHT), the local community housing provider that has recently taken over management from Opus International Ltd.

NTHT were chosen as they can provide wider tenant support services, although this comes at a higher annual cost to Council.

Council rental policy puts rents at below 50% of the market, which is considerably lower than other councils around New Zealand, including Tasman District Council or other community housing providers who are typically 70% - 80% of market. Applying similar policies as used by other councils would increase revenue by $350,000 to $500,000 per annum.

Council is operating an annual deficit on its housing portfolio with a negative return on investment (ROI) of -2.8% in 2016/17. Unless measures are taken to increase rents, Council's role in housing will continue to need operational subsidy. Maintaining a status quo situation will need serious consideration of how Council will continue to adequately fund the current portfolio improvements let alone any future redevelopment activities in the medium to long term (15-25 years).

Council is not eligible to access the Income Related Rent Subsidy scheme (IRRS) via the Ministry of Social Development for low income social housing tenants nor the grants and loans now available to third sector community housing providers (CHPs).

Council's main options are to either divest or retain ownership. Each of these options has a number of further scenarios. The status quo is not a sustainable option.

The best option for Council is to sell the portfolio, with covenants that protect the social housing service, to a community housing provider. Examples of possible providers include NTHT or a national CHP such as Accessible Properties Limited (APL). These providers typically have:

- The expertise and focus to deliver quality social housing services
- The scale and capability to renew and expand the portfolio over time
- The skills to provide social housing support services
- The ability to more equitably deliver community and social housing. The current rent charging policy provides a level of benefit to the tenants that exceeds acceptable subsidy levels nationally and is inequitable for rate payers and other residents of Nelson on limited incomes.

When previous governments have provided funding support for council-owned housing, the funding priority has been for new housing stock. The emphasis over the last 10 years has been supporting and incentivising the development of CHPs. There is no indication from the new Labour-led government that they will provide councils with financial support for refurbishing existing stock or renewal; rather, the emphasis is likely to be encouraging councils to provide more affordable housing and to make more land available for housing.

2. Problem Statements

Council has high costs of management, a low rental policy and a decreasing ROI that is hampering Council's ability to maintain, renew and/or expand its community housing asset to meet demand.

There is inequity in providing a community housing asset and related tenancy/social services that only a very small number of eligible Nelson residents can access, or to ensure applicants in highest need are receiving the benefits of Council-owned community housing.

Council has decided that other community providers have better operational and governance capability to manage social housing and has outsourced this role to private providers and more recently a community housing provider that is better placed to own and operate community housing for those in most need.

3. Background

Council's community housing portfolio comprises 142 units within nine complexes. The units comprise a mix of bedsits (49), single bedroom units (50) and double bedroom units (43).

Council is the second largest community/social housing provider in Nelson after Housing New Zealand Limited (HNZC). HNZC has 569 units in Nelson (as at 31 March 2016). Almost 90% of these are 2 and 3 bedroom units. Council provides 3% of the Nelson rental market (0.8% of Nelson's total housing stock).

The portfolio was largely built using low interest Crown loans in the 1960-80s. It consists of single level units constructed out of low cost materials consistent with typical practices of the time for social housing. 82% of the portfolio is now 40 years old. The Orchard Street Flats were partially upgraded in 2011 via a HNZC suspensory loan of $1.17 million. The portfolio has a rateable value of $12,080,000 (QVNZ valuation, September 2015).

The following table provides a summary of Council's community housing portfolio.

Table 1: Nelson City Council's Community Housing Portfolio

Name and location		Number	Type of Unit	Age	Rateable Value
Orchard Flats	16-24 Orchard Street, Stoke	39	33 bedsits 4 single 2 double	1960s	$2,530,000
Songer Flats	1 St Francis Way, Nelson	6	6 double	1990s	$750,000
Nayland Flats	327 Nayland Rd, Stoke	18	17 single 1 double	1960s	$1,240,000
Devon Flats	45 Devon Street, Nelson	10	10 double	1980s	$1,160,000
Blackwood Flats	9 Blackwood Street, Nelson	14	6 bedsits 5 single 3 double	1970s	$1,190,000
Toi Toi Flats	124 Toi Toi Street, Nelson	20	17 single 3 double	1970s	$1,740,000
Russell Flats	179 Waimea Road, Nelson	20	7 single 13 double	1960s	$1,750,000
Atawhai Flats	73-75 Atawhai Drive, Nelson	5	5 double	1980s	$660,000
Renwick Flats	4 Examiner Street, Nelson	10	10 bedsits	1970s	$1,060,000
Total		**142**	**49 bedsit** **50 single** **43 double**		**$12,080,000**

4. Purpose and scope

This document provides a high level evaluation of scenarios for Council to either retain or divest its community housing portfolio.

The scope includes:

a. Analysis of condition assessments against property values and identification of locations that might be sold to fund improvements.
b. The extent to which Council's rent policy falls below that of other council policies.
c. Assessing a range of scenarios for retaining or divesting against a set of evaluation criteria (which are set out in section 7) including:
    - Assessing the viability of a transfer to a CHP
    - Assessing the advantages and disadvantages of a transfer to a CCO including experiences from other Councils such as Christchurch
    - Analysis of the advantages and disadvantages of leasing.

5. Condition assessment and potential for expansion

A summary of the general condition of the portfolio and possible infill potential is set out in the following table.

Table 2: Condition of portfolio and potential for expansion

Address	Site coverage[1]	Condition	Construction	Options	Issues
Orchard Flats	17% Site is partially utilised.	Mixed, some very poor.	Short run iron roof, stucco walls, double glazed aluminium joinery.	$877,000 remains of the suspensory loan that would likely need to be paid off. The upgrade works funded from the loan have over-capitalised the property which makes redevelopment unfeasible. Hold in the short term and consider possible redevelopment potential.	Partial upgrade completed but still considerable deferred maintenance including accessibility issues, bathroom upgrades not compliant, old chimneys remain and some of the roof, partly original, is lifting in places. Poor tenant management has resulted in tenants adding cladding to porches and hoarding issues.
Songer Flats	16% plus large shared driveway. Fully utilised.	Excellent	Iron roof, fibre cement walls, aluminium joinery.	Sale/lease to the adjoining owner, Abbeyfield, may be an option to extend their retirement accommodation.	Well maintained asset. Good access.
Nayland Flats	20.15% Fully utilised site.	Fair	Iron roof, stucco walls, mix of wooden and aluminium joinery.	Possible future redevelopment site.	Old chimneys remain. Roof is original. Added cladding to porches looks shabby. Significant drainage issues.

[1] The analysis assumes that 35% maximum site coverage is a planning requirement.

Address	Site coverage	Condition	Construction	Options	Issues
Devon Flats	21.61% Fully utilised.	Good	Metal tile roof, fibre cement walls and aluminium joinery.	No options for further development.	Average condition. Good access. Dux plumbing. Needs repainting. Roof needs moss treatment and recolouring.
Blackwood Flats	28.6% Fully utilised.	Very good	Trough-section iron roof, stucco walls and aluminium joinery.	May be possible to make some of the units fully accessible.	Good exterior access.
Toi Toi Flats	23.95% Fully utilised.	Average	Iron roof, fibre cement weatherboard walls, and aluminium joinery.	No options for further development.	Possible fibrolite cladding (asbestos). Mixed accessibility.
Russell Flats	15.45% Under-utilised.	Fair	Corrugated iron roof, fibre cement walls.	Underutilised site, ripe for redevelopment. Sell/partner for a tagged, high density redevelopment.	Possible fibrolite cladding (asbestos). Drainage issues. Deterioration of laserlight on porches.
Atawhai Flats	19.73% Fully utilised.	Fair	Metal tile roof, fibre cement weatherboard and aluminium joinery.	No options for further development.	Weatherboard possibly weatherside, showing some deterioration of lower boards. Dux plumbing. Good exterior access.
Renwick Flats	23.66% Fully utilised.	Good	Corrugated iron roof, stucco walls, and aluminium joinery.	Valuable site near town and commercial area. Sell and re-invest.	Very small units.

Condition assessment

Council has limited information on the full condition and maintenance liability for the complexes. There is no Asset Management Plan. The Opus report of 2014 outlines a condition assessment at a very high level (largely superficial elements only) and did not consider the age of the units, obsolescence of design or the deteriorating condition of some of the building fabric, e.g. plumbing systems, original roof replacement or the changing needs of the tenants. The $620 annual maintenance allowance per unit has proven to be totally inadequate. Current actual average annual expenditure is almost twice the budget at $1,179 per unit.

The condition of the units ranges from fair to excellent. Most of the properties are tidy and are maintained to a reasonable standard. The grounds are very well maintained.

All the complexes are dated in terms of design and functionality. Access is an issue in most complexes with no fully accessible units available.

To meet today's quality standards there is an expectation that properties will provide a healthy, safe, accessible and warm environment. If Council were to commit to a generally accepted standard of accommodation the portfolio would require items such as ventilation systems, full insulation, an affordable heating system, accessible showers, mobility scooter parks and charging areas and more accessible entrances and interiors. In many of the complexes this may not be fully possible. Essential elements that do need addressing immediately include:

- Dux plumbing removal

- original roof replacement in two of the complexes (remove chimneys at the same time)
- a survey of all the complexes to determine any presence of asbestos
- some cladding replacement
- better tenant management around tenant alterations to porches
- addressing tenant hoarding (which creates potential health risks and access risks particularly in the event of an emergency).

It is understood there is capital funding available in the Community Housing Reserve of $340,000 that could cover some or of this immediate maintenance work.

A significant amount of maintenance and capital investment will be required on an ongoing basis as 82% of the portfolio is now over 40 years old.

To understand the full extent of the maintenance liability, a detailed assessment needs to be done on all elements of the properties and a budget established for each complex. This will determine immediate and future costs and also provide information on each complex to assist in determining the priorities for redevelopment.

Therefore there is a contingent liability over the portfolio. It is estimated that, if ownership is retained, Council may be faced with a requirement to replace up to 50% of the total portfolio in the next 20 to 25 years. Council's indicative cost of replacement and upgrade for the community housing portfolio is estimated using the assumptions in the table below.

Table 3: Indicative cost of replacement of Council's community housing portfolio.

	Assumptions	**Total Cost** (2017 dollars)
50% of portfolio is replaced – 71 units at 65m^2	4615 m^2	
Cost per m^2 (excluding GST)	$3,000	$13,845,000
Other improvements	5% of cost	$692,250
Demolition allowance	12% of cost	$1,661,400
Inflationary allowance	2% of cost	$276,900
Total - 50% portfolio replacement		**$16,475,550**
50% of portfolio is upgraded – 71 units at, say, $60,000 per unit		$4,260,000
Total renewal cost (2017 dollars)		**$20,735,550**

Portfolio financial performance

In the 2016/17 financial year, income generated from rents was $803,201 against operating expenditure of $814,867 resulting in an end of year deficit of -$11,666 and a negative Return on Investment ("ROI") of -2.8%. This is well below other local councils' financial objective of housing being a cost neutral activity (for example Tasman District Council).

Much of the operating spend in 2016/17 was attributed to maintenance and management costs. The total cost of maintenance in 2016/17 was $173,335 ($1,180 per unit) being 2.2% of total improvement value of $7,635,000. While in line with normal expectations, this level of maintenance spend will not be sustainable given the age of the portfolio and the short to medium term maintenance requirements identified above.

The portfolio has been managed by Opus for the last nine years at a current cost of [redacted]. While slightly above the market rate for property management of 8%, the high level of property and tenancy management witnessed from a brief review of the portfolio would seem to justify this level of expenditure.

In July 2017, a request for proposal was issued by Council and the NTHT was successful in securing the new property and tenancy management contract. The contract commenced on 1 November 2017. The cost of this management contract is [redacted]. It is understood the increase in cost of [redacted] is due to the expectation by Council that NTHT will provide significantly more tenant support than provided in the previous contract.

The current financial model of the portfolio is not sustainable at current rental levels and in time this will worsen as the levels of maintenance increase and the current tenants require further support to sustain their units.

Targeting

To be eligible for Council's community housing, the 'targeted market' is pensioners with limited financial resources. The current policy is defined in the Community Housing Policy 2009.

The eligibility criteria's first priority is older persons over 65 years with limited financial assets ($45,000 for a couple and $25,000 for a single person). The second priority is beneficiaries over 55 years.

There is no evidence of compliance with the targeting policy. Rather, the eligibility procedures are via a self-disclosure process with no formal checks being required. Waiting lists have been managed by Opus's Property Manager.

Currently the Council waiting list is 50 and the average turnover for the last five years has been only 12 per annum (8%). At this very low turnover rate, few on the waiting list will be successful.

As there is no formal implementation of a targeting policy or an allocation process to identify those in greatest housing need, it would be prudent in the future that Council seek a formal validation of applicant's financial position to ensure the subsidy being provided is justified (i.e. added benefits offered by Council, especially the well below market rental rate) plus a list of criteria to determine those in greatest need are being housed. This would ensure applicants in highest need are receiving the benefits of Council-owned community housing.

Other Councils have partnered with social agencies to provide client referrals and to provide pastoral care and general support. This reduces Council's costs and provides more appropriate support to better meet tenant's needs. It also helps with the difficult decisions when tenants can no longer manage to live independently. The new contract with NTHT will no doubt provide for this role.

Rental policy

Under existing Council policy, rental rates are set at the equivalent of 25% of New Zealand Superannuation.

Current rental rates range from $97.55 per week for a single person in a bedsit to $150.07 per week for a couple in a one bedroom unit. This corresponds to $850,000 per annum (or about 50%) below the average market rent in the Stoke and Nelson markets and well below the rental charged by other Council and community housing providers (mostly at 70% - 80% of market.)

Current market rentals in the lower quartile are as follows:

Source: MBIE Tenancy Services	Nelson	Stoke
Average market rental per week in the lower quartile	$226	$205

	Couples	Singles
Current Nelson City Council rents per week (2017)	$150.07	$97.55

On this basis, Council's rental charging policy is delivering a significant rent subsidy to a small proportion of its residents - at least $65 per week below market for a couple in Stoke.

Council has 99 single units and 43 doubles. 57 are in Stoke and the balance of 85 in Nelson.

The market rent for the total portfolio is $1,665,300 and the gross rental received for the total portfolio is $814,876 (in the 2016/17 financial year).

A 70% rental policy would realise $1,165,710 (or an additional $350,000 per annum) and an 80% policy $1,332,240 (or an additional $517,000 per annum). This would make the portfolio more sustainable but would not address future renewal costs.

The current rent charging policy provides a level of benefit to the tenants that exceeds acceptable subsidy levels nationally and is inequitable for rate payers and other residents of Nelson on limited incomes. Tenants of neighbouring Councils such as Tasman pay an affordable rent at a much higher level. Tasman District Council charges 80% of market.

Summary

Our overall assessment is that Council plays an important part in the delivery of housing options for older persons within its community. Better targeting, a more appropriate rental policy, and more cost recovery initiatives would ensure a better financial position and a more sustainable business model in the medium to long term.

The need for community and social housing in the Nelson region is forecast to increase, particularly due to the ageing population. This will drive demand for older persons housing and more affordable accommodation as building costs increase[2].

Council at this point in time is not in a financial position to respond to any future housing demand through direct housing interventions.

Just maintaining a status quo situation will need serious consideration of how Council will continue to adequately fund the current portfolio improvements let alone any future redevelopment activities in the medium to long term (15-25 years).

6. What are other Councils doing?

Several Councils around New Zealand have recently leased or sold their portfolio to a CHP. Christchurch City Council has leased part of their portfolio to the Otautahi Community Housing Trust.

Christchurch City Council (CCC)

CCC have provided social housing since the 1930s. They are the largest provider of social housing in NZ after HNZC.

The Otautahi Community Housing Trust (Trust) was established in late 2016 and they now manage 2,300 of the Council's units under a Deed of lease. The Trust is a Category 1 registered Community housing provider, which means unlike Council they can access the income related rent subsidy (IRRS) from central government for each new tenant referred to them via the Ministry of Social Development, whereby the tenant pays 25% of their income in rent and the Trust gets the shortfall to market.

Existing tenants currently pay 50% of the market rental and rents under the Deed of Lease are capped at no more than a 5% rent increase annually. New tenants that are not eligible for IRRS pay 70% of the market. The Trust states that this level was chosen as it reflects other rental charging policies by CHP's across the country.

Tenancy management is more intensive with tenancy mangers responsibility for half (200) the number of units than in the previous Council structure.

The Trust expects to pay the Council $12million per annum in rent to cover maintenance, redevelopment and replacement programmes.

The Trust has three councillors on the board and four independent members.

[2] Over the five years from 2012 to 2016, the cost of a new house (excluding land) increased by 26.4% - CPI purchase of new housing index, Statistics NZ.

Hamilton City Council has recently sold its portfolio to Accessible Housing (New Zealand) Limited.

Hamilton City Council (HCC) sale to Accessible Properties (New Zealand) Limited (APL)

In March 2016, HCC transferred its 344 pensioner housing portfolio to APL. APL has been a housing provider to people with disabilities since the 1950s and is now the largest social housing provider in New Zealand. It has considerable capacity for growth and development and was a significant recipient of the Social Housing Unit Fund, receiving about $20 million during 2010 – 2012. APL has undertaken many new large scale developments throughout the country over recent years.

The Hamilton transfer conditions included a guaranteed tenure for existing tenants and an affordable rental. Since the transfer APL have undertaken a tenant review of circumstances and implemented a new rent policy.

APL is a registered social housing provider and therefore new tenants are eligible for the Income related rents subsidy. They state that 50% of their new tenants come via the Ministry of Social Development and are eligible for the subsidy, the balance pay, about $185 per week.

Former HCC rents were set around $130 to $145 per week. For existing tenants, APL are gradually increasing rents to $170 per week over a four year period. Significant support has been given to tenants to ensure that they receive the rental benefits available through the accommodation supplement. APL state that the implementation of the new rental policy has been received well by tenants.

A review of circumstances recently undertaken ensures up to date information is available for effective targeting. APL requires verification from all tenants of income, assets and a Work and Income statement. Random checks are also made with the Companies Office and online property ownership records to ensure compliance with eligibility requirements.

7. Should Council divest or retain community housing?

Council has two main options – either divest or retain the portfolio. Within these options, there are several scenarios. These comprise:

Table 4: Community housing portfolio options

Retain Ownership	**Scenario 1 – Status quo** – whereby Council maintains ownership of the portfolio and the Nelson Tasman Housing Trust manages the portfolio under contract at existing budget levels and allows the quality of the portfolio to be run down to below acceptable standards.
	Scenario 2 – Renew asset – whereby Council commits additional rates funding to bring the portfolio up to an acceptable standard recognised in the sector.
	Scenario 3 – Expand asset – whereby Council commits additional rates funding (and central government funding depending on new government policy) to provide additional community housing.
	Scenario 4 – Lease to CHP – whereby a CHP manages the housing portfolio under a net lease whereby it would be responsible for all operating costs including rates (albeit with some rent relief as a charitable organisation) and day-to-day maintenance.
	Scenario 5 – CCO – Council transfers the portfolio to a Council Controlled Organisation (CCO) with an independent board. Council must maintain a minimum of 50% ownership[3] with one or more other private and/or community housing providers holding the other 50%.

Divest Ownership	**Scenario 6 – Private sale** where Council discontinues delivery of the community housing service and a private provider purchases the portfolio on the open market and continues to rent and/or redevelop the portfolio on a full market rental basis.
	Scenario 7 – Sale to CHP where a CHP owns and may continue to operate the community housing portfolio in compliance with regulatory requirements.

[3] The Local Government Act 2002 requires in Section 6 that council ownership in a CCO must be 50% or more, or if owned by multiple councils the combined ownership must be 50% or more.

Option evaluation criteria

To evaluate and determine the best option(s) for Council, each option scenario needs to be assessed against criteria. These comprise:

Table 5: Option evaluation criteria

1	Protects the rights and welfare of existing tenants including affordable rental, minimum unit standards, tenant welfare services and security of tenure.
2	Ensures long term sustainable financial operation of the portfolio, i.e. is commercially viable for a CHP.
3	Enables maintenance / modernisation / redevelopment opportunities to increase supply to be considered.
4	Minimises calls on Council's financial resources now and in the future.
5	Ensures long term provision of quality social housing within Nelson district.
6	Ensures Council can maintain long term control over future use of the portfolio.
7	Ensures equity of support services for all low income and elderly residents within the city.
8	Provides added benefit and value to the community.
9	Provides a growth opportunity for a local housing trust.
10	Leverages private finance for new supply.
11	Leverages private finance for stock upgrade.
12	Ensures operational efficiency.
13	Enhances long term asset management.
14	Provides effective governance.

Evaluation of Options

The results of a high level assessment of these option scenarios against the criteria are set out in the following table.

Table 6: Option evaluation summary

		Retain Council Ownership					Divest Council Ownership	
	Option	1 Status Quo	2 Renew Asset	3 Expand Asset	4 Lease to CHP	5 CCO	6 Private sale	7 Sell to CHP
1	Protects the rights and welfare of existing tenants including affordable rental, minimum unit standards, tenant welfare services and security of tenure	×	✓	✓	✓	✓	×	✓
2	Ensures long term sustainable financial operation of the portfolio, i.e. is commercially viable for a CHP	×	×	×	?*	×	×	✓
3	Enables maintenance / modernisation / redevelopment opportunities to increase supply to be considered	×	✓	✓	×	✓	×	✓
4	Minimises calls on Council financial resources now and in the future	×	×	×	×	×	✓	✓
5	Ensures long term provision of quality social housing in Nelson for low income residents including older people	×	✓	✓	✓	✓	×	✓
6	Ensures Council can maintain long term control over future use	✓	✓	✓	✓	✓	×	✓
7	Ensures equity of support services for all low income and elderly residents within the city	×	×	×	×	×	×	✓
8	Provides added benefit and value to the community	×	×	×	×	×	×	✓
9	Provides a growth opportunity for a local housing trust	×	×	×	×	×	×	✓
10	Leverages private finance for new supply	×	×	×	×	×	×	✓
11	Leverages private finance for stock upgrade	×	×	×	×	×	×	✓

	Option	Retain Council Ownership 1 Status Quo	2 Renew Asset	3 Expand Asset	4 Lease to CHP	5 CCO	Divest Council Ownership 6 Private sale	7 Sell to CHP
12	Is operationally efficient	×	×	×	✓	✓	×	✓
13	Enhances long term asset management	×	✓	✓	×	✓	×	✓
14	Provides highly effective social housing governance	×	×	×	✓	✓	×	✓
Overall		××	×	×	✓	✓	××	✓✓

* Where the lease is to a registered community housing provider, new tenants are eligible to apply for IRRS. In Hamilton, for example, 50% of new tenants have been eligible (must have assets of less than $6,000).

Best fit against criteria

Scenarios to retain ownership of community housing

1. *Status quo*

Key points

- Council retains its community housing portfolio to provide low rental housing for older persons.
- Council continues its low rental policy of 25% of Government Superannuation.
- NTHT continues to provide lease and tenancy services under a management contract to Council.
- The age of most of the units means major maintenance works such as replacing Dux plastic plumbing, roof replacement and assessing/addressing asbestos in exterior cladding.

Council would continue to outsource management to the NTHT, maintain a similar level of service to tenants and underwrite the operating costs of delivery. The budgeted deficit for 2017/18 is $58,000 and these deficits would continue. This is suboptimal as it does not enable upgrade work to be funded from surpluses but requires additional calls on rates.

Ongoing maintenance issues under the status quo would include likely roof and plumbing upgrades over the next 3 years such as replacing Dux plumbing and addressing asbestos in exterior cladding and interior surfaces.

However, under this scenario there would be no provision for long term capital costs of future upgrade and redevelopment costs associated with renewing the portfolio when the assets become obsolete, likely to begin within 20 years. This means Council would continue to 'run down' the portfolio.

Assessment

Existing tenancies will be protected but the status quo will not respond to the growing housing needs of the Nelson community, particularly the ageing and very low income renter market whose needs are unlikely to be met by the open market.

The quality of the housing will continue to decline over time while maintenance costs continue to increase resulting in increasing annual portfolio deficits subsidised through rates.

HNZC[4] (as with most provincial centres) will continue to reduce their presence within the Nelson area as they focus on locations with a higher housing need, for example, Auckland and Christchurch, placing further pressure on Council community housing.

[4] HNZC has 569 units in Nelson (as at 31 March 2016). Almost 90% of these are 2 and 3 bedroom units.

2. Renew asset

Key points

- Renewal ensures the continuation of community housing in Nelson for the long term.
- Renewal would cost Council in excess of $20 million over the next 25 years, significantly increasing debt.
- Even with a rental policy increase, significant rates funding would be required.
- The inequity of providing an asset only accessible by a few is not resolved.

Council would undertake a mix of upgrading and replacing the portfolio to bring it up to modern standards that would require items such as ventilation systems, full insulation, affordable heating systems, accessible showers, mobility scooter parks and charging areas, and accessible entrances and interiors.

We estimate the costs for renewing at least 50% of the portfolio to be about $16 million in the next 20 to 25 years, with a further $4 million to 5 million to upgrade the remaining 50% - a total of at least $20 million. (Refer to Table 3 on page 7.)

Government is no longer providing low interest or suspensory loans and Council would not have access to non-government organisation (NGO) funding, which means obtaining debt funding on the open market.

To minimise the level of debt, selling two of the complexes could release approximately $3 million. Given the high proportion of bedsit units within the portfolio, Council would need to rebuild and intensify the other sites to maintain the current size of the portfolio, which would mean building some two story complexes to fully utilise sites.

Funding interest of say $1 million (on debt of $20 million at 5%) and continuing the current contract for management and tenant support , even with a change in rent policy that increased rents to 80% of market, would require additional rates funding of more than $700,000 per annum.

While this would ensure the long term provision of community housing in Nelson, it requires ratepayer subsidisation and does not address the equity issue of providing an asset that only a very small number of eligible residents can access.

Council does not have the specialist capability, management capacity and governance structure to redevelop properties and continue managing the asset.

3. Expand asset

Key points

- Expansion could be achieved by redeveloping existing sites or adding new locations.
- Depending on the scale, Council would be faced with increased debt.
- Council would still need to address renewal requirements.
- The inequity of providing an asset only accessible by a few is not resolved.

To cater for growing demand, Council could increase the number of units either by intensifying (demolishing and rebuilding on suitable current sites) or by developing new sites, although suitable new sites are likely to be difficult to find.

The need to significantly upgrade or renew the existing portfolio over the next 25 years is still required. Therefore the practical development of this ‘Expand’ scenario is an extension of the renew scenario, whereby renewal sites are intensified to provide additional units.

The asset would add to housing for older people only, as Councils are excluded from accessing social housing tenants with IRRS-eligibility. The equity issue of significant Council assets available only to a few is exacerbated.

As with the 'Renew' scenario above, Council would need to increase debt. Also, Council is not best placed to develop properties or to provide wider social housing services.

4. Lease to CHP

Key points

- Council no longer directly provides housing to older persons.
- The portfolio continues to be owned by Council and leased to a CHP.
- Council remains responsible for costs of long term maintenance and renewal.
- The CHP is likely to want to offer the housing as social housing for IRRS-eligible tenants and therefore expand the entry criteria beyond older persons.
- [redacted]

Council retains ownership of its community housing portfolio and leases it to a CHP. The CHP would be responsible for the operation, management and day-to-day maintenance of the properties and provide all tenant and welfare services. Existing tenants' rents and tenure could be grandparented as long as they remained eligible.

A CHP can access IRRS if they make some of the housing available for social housing but would not be able to access Government capital funding as they do not own the portfolio. Councils are excluded from accessing IRRS and would be unlikely to access further Government capital funding.

The CHP is likely to want to introduce a rental policy based on a percentage of market rents (e.g. 70%) for new tenants, introduce IRRS-eligible tenants over time, and bring increased scale and efficiency, thereby making the portfolio more viable commercially.

This would change the current purpose of Council's housing targeting only older people by providing social housing to those who meet Ministry of Social Development criteria. This would be a more equitable use of Council's portfolio, but would require care in the location of the different mix of tenants.

A lease structure would not provide the leverage ability or the autonomy any CHP would need to develop more or better social housing options within Nelson. This is because the CHP would be unable to raise money against the value of the asset to add to the portfolio. As such, this option does not provide long term surety of provision of community/social housing for Council or the CHP. However, it could be a way to transition to a sale to a CHP and would enable the CHP to build capacity and transition to new tenants on IRRS.

5. Sale to a CCO

Key points

- Council, potentially in partnership with other Councils, must hold 50% shareholding[6].
- Costs are higher due to one-off establishment costs and additional annual governance and management costs.
- No economy of scale gains are achieved unless partnering with another Council or housing provider.
- Duplicates capability and systems already available through NTHT, other CHPs and Council itself.
- Retains Council's disadvantages of not being able to access IRRS tenants or capital funding available to a CHP.
- If the CCO is a profit making company, this Introduces taxation complexities and is unlikely to be tax-effective.

[5] [redacted]

[6] Local Government Act 2002 Section 6

A CCO[7] can be engaged in delivery of services on behalf of a territorial authority through three main mechanisms:

i. Sale of assets and transfer of services
ii. Lease of assets and transfer of services
iii. Delivery of services under a management contract.

How would it work?

The CCO would provide the governance, tenancy management, and provision of wider tenancy services for the tenants of Council's community housing. This would involve:

- Setting up an establishment project including legal arrangements, recruitment, premises, etc.
- Establishing a governance board and management team and policies, systems and procedures including financial and IT support, insurance, accounting and audit.

Council would transfer the assets to the CCO under a sale/purchase agreement. Alternatively, Council could lease the assets to the CCO (which is effectively scenario 4 above without the benefits that a CHP could achieve through IRRS-subsidised market rentals).

Council would likely need to fund working capital and any operational cashflow shortfall.

Advantages

- Community housing could be rebranded which could make it easier to change the rent policy closer to market rents (as per other councils such as Tasman District Council's policy)
- Potential to provide wider support services
- Clearly defined service levels
- Transparency of costs that makes explicit any Council subsidisation
- Potential to drive cost reduction and more efficient, focused service delivery and maintenance
- Establishes a purchaser/provider split that incentivises clear specification of the desired service and potentially more efficient delivery
- Would provide a vehicle for joint operation with one or more other Councils
- May be possible to secure funding from other shareholders.

Disadvantages

- Duplicates capability already available within the NTHT and Council.
- Council still owns the asset and cannot have less than 50% ownership.
- The cost structure is higher (because of one-off establishment costs and ongoing governance and management costs, etc.) with no economy of scale achieved
- Funding issues remain and the CCO would have no additional ability to renew or expand the asset unless other shareholders bring funding
- Council may not be able to attract other shareholders

[7] Under Section 6 of the Local government Act 2002 (LGA), Councils can establish Council Controlled Organisations (CCO) in which 50% or more of the equity is held by one or more territorial authority. The definition under the LGA covers a wide range of entities and/or commercial arrangements including companies, partnerships, trusts, arrangements for sharing profits, joint venture, or other similar arrangements. Any proposal to establish a CCO is subject to a special consultative procedure and good practice would involve the preparation of an establishment plan. A CCO must have a statement of intent. Directors of CCOs are appointed in accordance with a policy and must have appropriate skills, knowledge and experience to guide the organisation and contribute to the achievement of its objectives.

- IRRS subsidies cannot be accessed by Councils or related organisations
- Income tax is payable on surpluses. Any tax losses may not be easily utilised and depreciation on buildings purchased is not be deductible (depending on government taxation policy that may apply at the time).

Costs

Estimated additional costs of establishing and operating a CCO comprise:

CCO Establishment	$000
– Legal	40 – 60
– HR / recruitment	40 – 60
– Rearrangement of premises	10 – 20
– Change management support	10 – 20
	80 – 160
CCO additional annual ongoing costs	
– Governance and management	100 – 150
– Systems – Financial and IT (and website, etc.)	30 – 50
– Accounting and audit	30 – 50
	160 – 250

Scenarios to divest community housing

6. *Private sale at full market value*

Key points

- Council would no longer provide community housing.
- The community is unlikely to accept this unless there is a suitable alternative such as a CHP.
- The whole portfolio would be sold on the open market for the highest price.
- There would be no requirement on the buyer to deliver social housing.
- Council would avoid major maintenance, upgrading and renewal costs of an ageing asset over the next 25 years.
- Council would be required to repay the HIF suspensory loan of $1.17 million.

For this scenario to proceed, Council would need to set aside its community/social housing objectives. This is unlikely to be acceptable to the community, particularly at a time of increasing demand for social housing for older adults. Nelson experienced population growth of 8.5% between 2006 and 2013 (last census) and the growth in the over-65 age group increased from 14.5% to 17.5%, higher than the national average of 13.5%.

The key advantages of private sale are that Council would:

(i) exit an asset and service that struggles to break-even annually ($58,000 budgeted deficit for 2017/18)
(ii) maximise the sale value of the asset and use the funds for other purposes
(iii) avoid major maintenance costs such as roof replacements and remedying asbestos cladding.

Council could struggle to find private investors of sufficient scale interested in acquiring the portfolio as a whole or in part. Council would more likely attract smaller residential investors seeking to acquire individual complexes and these investors would be seeking higher returns than they would likely realise in other locations or from other investment classes.

Council could impose covenants on use or delivery as community housing but this is unlikely to provide the future commercial upside from rental growth or redevelopment potential that these investors would require.

Such a sale would require Council to repay in full their suspensory loan of $1.17 million and would also require Council to comply with Section 40 of the Public Works Act 1981 (PWA).

7. *Sale and transfer to a registered Community Housing Provider*

Key points

- Achieves the outcome of a more sustainable social housing model – a CHP would be a focused expert owner.
- Council would no longer directly provide community housing; however a CHP could actually provide better services with more long term certainty.
- CHP could access government and other funding to manage renewal/upgrade/expansion that is unavailable to Council.
- CHP could access IRRS-eligible tenants.
- CHP would add some economy of scale and operate at higher rentals to achieve a more viable return on investment and to reinvest surpluses.
- May be possible to transfer HIF suspensory loan as part of the sale process.

Council would no longer provide community housing directly; rather, it would transfer this role to an existing CHP [redacted]

The transfer would involve sale of Council's community housing portfolio of 142 units to an existing CHP (social housing company or trust entity) at a realistic 'social housing transfer value'. The CHP would assume the long term responsibility for owning, managing and growing the social housing asset and responding to wider housing needs including the ability to sell some locations and use the proceeds to redevelop and expand other locations.

The CHPs core role would be rental housing but surplus revenues could also allow for a wider scope of housing activity, for instance supported/shared equity home ownership. [redacted]

Council could offer to sell to the NTHT who currently manage the portfolio and tenancies or it could consult with social housing providers to assess sector interest and capacity to purchase the portfolio through a market sounding and/or Expression of Interest process.

Council's role in this option would be limited to assisting in the transfer process for Council's assets, including:

- Carrying out due diligence on the CHP and agreeing the basis for calculating transfer value
- Transition planning with the CHP
- Provisional debt funding arrangements
- [redacted]

As a condition of sale, Council may require a 'non-controlling' governance role within the structure of the CHP in relation to the transferred assets, to ensure the long term provision of community housing for Nelson. For example, Horowhenua District Council, who in November 2017 sold their community housing portfolio to Compassion Housing, required one seat on the board. (Compassion Housing also purchased the Upper Hutt portfolio.)

Because of the resulting scale of expected asset and tenancy management (and new housing development) we have assumed that the new entity will have existing in-house capabilities or utilise its existing infrastructure used elsewhere.

A condition on the sale would need to ensure that the local interests are protected and the local management structure is adequacy resourced.

[redacted]

- [redacted]
- [redacted]
- [redacted]
- [redacted]
- [redacted]

8. Conclusion

Council's community housing portfolio is ageing (80% are more than 40 years old). The portfolio will need maintenance to the fabric of the buildings – roof, plumbing, joinery and cladding – over the next five years. This will deplete Council's Community Housing Reserve of $340,000.

The standard of accommodation does not meet today's quality standards that properties will provide a healthy, safe, accessible and warm environment which would require items such as ventilation systems, full insulation, an affordable heating system, accessible showers, mobility scooter parks and charging areas and more accessible entrances and interiors (which is not possible in many of the complexes).

Within the next 25 years, about half of the portfolio will require renewal at a cost in the order of 20 million (in 2017 dollars). Council is not in a strong financial position to readily respond to future increased housing demand through direct housing intervention.

Selling one or two of the existing complexes on the open market, as in the Renew Scenario, would only release about $3 million. This would be insufficient to redevelop other sites without significant additional funding. Due to the high proportion of bedsits within the portfolio, such redevelopment could have the effect of reducing the number of units available.

The current rent charging policy (25% of New Zealand Superannuation) provides a level of benefit to the tenants that exceeds acceptable subsidy levels nationally and is inequitable for rate payers and other residents of Nelson on limited incomes. Tenants of neighbouring Councils such as Tasman pay an affordable rent at a much higher level. Tasman District Council charges 80% of market. Such a policy would provide more capacity to fund significant maintenance and renewal or expansion. The current rental policy is a key factor causing Council's current negative return on investment (-2.8%).

The preferred way forward is to transfer the portfolio to a CHP at a realistic 'social housing transfer value' that recovers Council's book value of the asset and removes the contingent liability for increasing maintenance and upgrading of ageing buildings. This would enable a CHP over time to provide wider social housing including tenants that can access IRRS [redacted]. CHPs can also access low cost government funding no longer available to Councils.

The alternative of leasing the portfolio to a CHP would mean Council retains its contingent liability for major maintenance to the fabric of the buildings and the longer term need to fund renewal without access to the low cost government capital funding available to CHPs.

Similarly the option of using a CCO structure to partner with other organisations requires 50% shareholding by council(s), does not remove Council's contingent liability for maintenance or better fund renewal, and comes at increased cost of set-up and annual operation.

9. Recommendations

It is recommended that:

1. A detailed assessment is undertaken of all elements of the properties and a realistic maintenance budget established for each complex to determine immediate and future costs and priorities for redevelopment.
2. Council introduce a community housing rental policy that:
    a. Requires formal validation of applicant's financial position to ensure the subsidy being provided is justified and that applicants in highest need are receiving the benefits of Council-owned housing
    b. Sets rentals at 70% - 80% of market but not exceeding 35% of income (New Zealand Superannuation) for all new tenancies and transition existing tenants over a three year period.
3. Council no longer directly provides Community Housing as a core Council service; rather, Council continues to take a leadership role in advocating and facilitating for wider community issues with regards to accessibility and affordability of quality housing.
4. Council seek expressions of interest from CHPs for the sale and transfer of Council's Community Housing portfolio.

10. Next steps

If Council agrees with the recommendation for sale of its community housing portfolio to a registered CHP, then the next steps are to:

1. Develop a community housing transfer information memorandum seeking registrations of interest for its community housing portfolio based on the following specific objectives:
    (i) The CHP is sustainable within the Nelson area and:
    - Is committed to the long-term delivery of affordable rental housing of good quality
    - Will seek to grow its social housing role in Nelson
    - Wishes to provide an integrated wrap-around service for the target population.

    (ii) The CHP provides security of tenure for all tenants for the duration of their need, while also maintaining their rights and welfare.

[redacted]

(v) The CHP ensures that any residual obligations associated with Council's Housing Innovation Fund ("HIF") suspensory loan are met.

2. A request for proposal would then be sought from parties considered acceptable from the registration of interest.