TE KĀINGA UPDATE

PUBLIC EXCLUDED

Grounds: **Section s48(1)(a) - That the public conduct of this item would be likely to result in the disclosure of information for which good reason for withholding would exist under Section 7.**

Reason: **Section 7(2)(i) - The withholding of the information is necessary to enable the local authority to carry on, without prejudice or disadvantage, negotiations (including commercial and industrial negotiations).**

Kōrero taunaki | Summary of considerations

Purpose

1. This report intends to update the Unaunahi Māhirahira | Audit and Risk Committee on the risks associated with the operation of Council's affordable housing programme, Te Kāinga. This is the second of the annual updates provided to Committee.
2. The report will summarise for noting, key risks associated with the programme, including long term risks, ongoing operational risks and risks associated with the pipeline of development.
3. The report outlines and summarises risks reported to Committee in November 2023, as well as any new risks that have emerged since.
4. The report outlines the mitigations that are in place to manage risk associated with the programme.

Strategic alignment

Relevant previous decisions

5. 22 March 2018, City Strategy Committee – approval of the development of the policy settings for the programme. Officers provided advice on the key risks of the programme including the untested nature of the programme and the financial risks associated with taking on long term liabilities.
6. 23 August 2018, City Strategy Committee – approval of the initial exemplar project (195 Willis) and officers provided updated advice on the risks associated with the project, including financial risks for the head lease.
7. 6 December 2018, City Strategy Committee – the exemplar project was expanded to include five proposals. Officers provided an updated risk assessment on the project.
8. 10 September 2020 – Haining Street introduced as a possible project – the first new build. The project was approved.
9. 2 June 2021, Social, Cultural and Economic Committee – target of 1,000 homes set.

10. 9 June 2022, Planning and Environment Committee – emerging risks were highlighted including rising costs of construction and changing market conditions. Councillors requested officer advice on changing the programme's tenant criteria.

11. August and November 2022 – briefings were provided [redacted]

12. 8 December 2022 – an update was provided [redacted]

13. 20 April 2023 – [redacted]

14. 8 June 2023, Environment and Infrastructure Committee – an update was provided on the Te Kāinga programme, [redacted] The report also notes risks associated with the programme and seeks to reconfirm the programme's priorities and direction. Council resolved to reinstate and reaffirm the 1,000 homes target.

15. 29 November 2023, Audit and Risk Committee – [redacted]

16. 8 May 2024, Audit and Risk Committee – [redacted]

Financial considerations

☐ Nil	☐ Budgetary provision in Annual Plan / Long-term Plan	☒ Unbudgeted $X

Risk

☐ Low	☒ Medium	☐ High	☐ Extreme

Author	Paul McCorry, Manager Housing Development
Authoriser	Liam Hodgetts, Chief Planning Officer

Taunakitanga | Officers' Recommendations

Officers recommend the following motion:

That the Unaunahi Māhirahira | Audit and Risk Committee:

1. Receive the information.
2. Note the risks associated with the operation of the Te Kāinga programme in the long-term, operationally and with the development pipeline.
3. Note that all the recommendations from the Risk and Assurance review have been implemented as of March 2024.
4. Note the other mitigations that are in place to minimise programme risks.

Whakarāpopoto | Executive Summary

17. This report details the risks that are associated with the operation of the Te Kāinga affordable rental programme, and the development of a building pipeline.

18. Committee agreed in the November 2023 update that officers would provide an annual update on the risks associated with the Te Kainga programme as part of increased risk management. This paper is the second annual update and builds upon the 2023 update.

19. [redacted]

20. [redacted]

21. Risks are categorised into long-term programme risks, current operational risks, and risks related to the development of a building pipeline. To prevent duplication, where risks were included in the November 2023 update to ARC, they are included in this report in summary only.

22. Risks are being actively managed, and mitigations are in place to minimise risk to the programme globally. This includes a Te Kainga governance board, the development of a Te Kainga operating framework (consolidated process document), revised legal documentation and financial modelling prepared by external subject matter experts, a revised business process aligning with the Investment Delivery Framework and strengthened internal capability and programme management.

23. As the programme involves often complex commercial and legal negotiation with the private sector, the programme continues to expose Council to risk. Whilst efforts are made to minimise risk, it cannot be excluded in totallity.

24. To date the programme has achieved 47.3% of the 1,000 unit target by 2026 and officers continue to negotiate on the balance with development partners. To achieve this in a safe way, a focus on risk management will remain paramount.

Takenga mai | Background

25. The Te Kāinga programme was proposed by former Mayor Justin Lester to convert buildings in Wellington's central business district (CBD) into residentail apartments. It was identified as a priority project in the Long-Term Plan and Housing Strategy (2018 – 2028).

26. Several risks were highlighted by officers at the time of the programme's inception, including:

    a. The concept of CBD conversions was untested and should have a pilot project to test pracitcal deliverability;

    b. Medium to long term liability i.e. commitment to a long-term lease represented a financial risk to Council for the lease term;

    c. Sensitivity to rent setting, i.e. risk assessment noted that headlease costs would need to reduce to produce an affordable (or even market rent);

    d. Concern that if Council provided rent subsidies or other financial support to make the product affordable, this could have significant ongoing cost implications and require (unbudgeted) funding.

27. Council resolved to approve an exemption to Council's Procurement Policy in December 2018, allowing five active unsolicited bid proposals to be considered as part of the programme.

28. The programme has three core objectives:

    e. The provision of affordable rents

    f. Delivery of these affordable rents in a cost neutral way

    g. Achieve 1,000 units by 2026 (under contract or delivered)

29. In June 2023, the Environment and Infrastructure Committee (EIC) reconfirmed their commitment to the Te Kāinga programme and the above core principles, including the 1,000 unit target.

30. [redacted]

31. [redacted]

32. As at November 2024, the programme contains four buildings and 290 apartments – 212 of which are managed by the Te Kāinga team, and 78 that are delivered in partnership with Victoria University of Wellington (VUW) through a sublease arrangement.

33. Of the 212 apartments managed by the Te Kāinga team, target occupancy is currently being achieved and typically ranges from 96-99% depending on the time of year. The programme remains in a cash positive position. Over the life of the leases, at a programme level and based on current assumptions, Te Kainga is forecast to achieve cost-neutrality.

34. Results from the latest tenants survey shows 91% of tenants would recommend Te Kāinga to family and friends, and 84% were satisfied. 67% of tenants agreed that they were getting value for money.

35. Two additional buildings are under contract and will be delivered in late 2025, taking the total number of buildings delivered or contracted to 473, or 47.3% of the 1000 unit target. A further tranche of buildings are in the pipeline and at various stages of negotiation

Kōrerorero | Discussion

36. This report should be read in conjuction with the previous Te Kāinga risk update to Audit and Risk Committee on 29 November 2023.

37. This report is the second annual update as agreed by Committee in November 2023 and builds upon the previous update.

Long-term programme risks

38. The long-term, programme-level risks remain the same as outlined in the 2023 update. These risks are summarised below.

39. **Untested concept**. There may be risks and issues that are yet to be encountered in the programme, [redacted]

40. **Long-term liability**. There is financial risk to Council due to the long-term nature of the lease, [redacted]

41. **Sensitivity to assumptions.** Financial modelling relies on assumptions over a long-term horizon. Assumptions include CPI inflation, rental market outlook and operational cost projections. [redacted]

42. **Delivery/reputational risk.** [redacted]

43. **Long term economic outlook.** Delivery of the 1,000-unit target wholly depends on prevailing economic conditions. Development partners report that securing finance remains a challenge, and when it is secured interest rates often challenge project viability.

44. **Unexpected increase in operational costs.** Costs could arise from major tenant damage, [redacted] due diligence requirements, software or staff costs. All of these could impact the financial sustainability of the programme.

45. **Occupany risk/loss of income.** Cost neutrality of the programme relies on target occupancy levels being achieved on a ongoing basis. Reduced occupancy could occur for several reasons, for example typology not equating to demand, significant new supply of more modern and more affordable accomodation options, reduced CBD population, economic changes, reputational damage to Council or Te Kāinga brand, declining apartment quality and systemic market changes.

46. [redacted]

47. **Legal and commercial risks.** Each project carries some level of legal and commercial risk by the nature of negotiation with the private sector in the deivery of the programme.

48. **Seismic risk.** Development partners are required to commit to new build projects being at least 100% NBS, [redacted]

49. **Refurbishment impact.** Te Kāinga leases include that landlords will contribute [redacted] for refurbishment [redacted] If this contribution is not sufficient to materially improve the quality of the apartments, it would result in Council paying a headlease which does not reflect the apartments' value, [redacted]

Operational risks

50. **Financial impact of reduced occupancy.** If occupancy does not achieve target levels for a given financial year, there will be negative variance to budget. Occupancy levels could drop for several reasons, including occupancy or rental income assumptions being too high, or rental increases causing people to find cheaper alternatives. [redacted]

51. **Public sector job losses.** Since the start of the programme, Te Kāinga has prioritised people working in job creation industries in Wellington, including the public sector. To date Te Kainga tenancy management team have observed a dip in occupancy in this FY however it is too early to determine if this is part of the normal seasonal softening of the rental market through winter. Data noted below does indicate that winter 2024 has been less active than winter 2023 and will continue to be monitored by the tenancy team.

52. **Softening rental environment.** TradeMe data shows demand for rental apartments in Wellington is down 16% for the year to October, while supply is up 17%. An comparative oversupply of rental accomodation means tenants can be more discerning and expect more quality for lower prices. [redacted]

53. **Service delivery and tenant satisfication.** There is a risk that tenants do not perceive they are getting value for money, are dissatisfied with the quality of their apartment or customer service from the Te Kāinga or building maintenance teams. Low satisfaction is likely to result in higher turnover and below-target occupancy levels which would impact the financial sustainability of the programme. Whilst the annual tenant survey indicates tenants are satisfied with the product and service, this is required to be monitored on an ongoing basis.

54. **Maintenance service.** For Te Kāinga leases, the building owner is responsible for providing a building maintenance service. [redacted]

55. **Rental legislation changes.** Central Government has proposed changes to the Residential Tenancies Act, most significantly in relation to termination of tenancies. If enacted, the changes would see a reintroduction of 90-day 'no cause' terminations for periodic tenancies and shortened notice period for tenants, amoungst other changes. Given one of the key pillars of the Te Kainga programme is security of tenure for our tenants – the ability to terminate for no cause may undermine this.

56. **Further rental legislation changes.** The bill also proposes to introduce a pet bond and includes that landlords can withhold consent for pets on reasonable grounds. [redacted] Any such changes to the RTA will therefore need to be worked through to ensure financial and reputational risks are minimised [redacted]

57. **Long-term financial position.** Financial forecasting currently indicates that the programme will be cost-neutral [redacted]

58. [redacted]

59. **Landlord cashflow issues.** Te Kāinga typically receives [redacted] monthly management fees. [redacted] delays in receiving these payments would result in less interest being received than forecast, or interest being accrued on debt. In the case of significant delay, the financial impact to the programme would be material.

Development pipeline risks

60. Te Kainga has achieved 47.3% of the 1,000 unit target. The target aims to have 1,000 units either delivered or under contract by the end of 2026. There are currently 290 apartments open and operational with a further 183 under contract for delivery in October 2025. Negotiations continue on the next tranche of development. [redacted]

61. **Non-delivery of 1,000 unit target.** High interest rates and construction cost increases result in developer partners requiring higher rent to make a deal work. Council requires commercial terms to be such that the core principles of the Te Kāinga programme are maintained, in particular that the project is cost-neutral and rents are at an affordable level to tenants. If favourable commercial terms cannot be agreed with a developer partner, then a deal will not be entered into. This puts the target of 1,000 units at risk.

62. **Softenining rental market.** As noted in the operational risk section the Wellington rental market has softened in 2024. In combination with developer requirements to achieve the highest headlease rent possible to satisfy interest and construction costs, Council require the achievement of the lowest possible headlease rent to ensure that our product can remain competive in the softening rental market. It remains a real possibility that both parties requirements cannot be achieved at the same time and an agreement cannot be reached.

63. **Market saturation.** The two new buildings under contract will add 183 apartments to the programme, of which 160 are studios or one-bedroom apartments. If the demand does not meet supply in terms of typology or quantity, the new buildings could have lower than modeled occupancy [redacted]

64. [redacted]

65. **Timing of new buildings.** Rental market demand in Wellington is seasonal and is materially lower between June – September than at other times of year, which makes this a challenging period to bring new buildings online. [redacted]

66. **New building programme delays.** Related is the reputational risk of a new building being delayed after a commencement date has been publicly announced, and tenancies secured with individual Te Kāinga tenants. Any damage to the Te Kāinga brand could result in financial impacts related to increased vacancy and reduced interest from potential tenants.

67. **Quality of new buildings.** [redacted] regular Project Control Group (PCG) meetings with the developer during the development phase. Any product that is inferior to the analysed market rental could result in the apartment generating lower than anticipated rental revenue [redacted]

68. [redacted]

69. [redacted]

Mitigations

70. [redacted]

71. **Programme governance.** A Te Kāinga Governance Board has been established since October 2023. The Chair is the Chief Planning Officer, and the membership includes representatives from Legal, Finance, Commercial Partnerships, Mataaho Aronui and Connected Communities teams. The Housing Development Team report to the board as advisors on the Te Kainga Programme. As per the Terms of Reference, the Board's responsibilities are to:

    h. Monitor progress towards 1,000-unit target.

    i. Monitor the programme's adherence to cost neutrality, including team operating budget.

    j. Identify risks and opportunities for management by Programme Manager or project managers.

    k. Review programme risk register in conjunction with Programme Manager.

    l. Advise on escalations from Programme Manager or project managers, including risks and issues.

    m. Endorse programme decisions and recommendations prior to presentation to the executive leadership team (ELT) and/or elected members.

72. **External expert advisors**. To further strengthen the Te Kāinga Governance Board, two new external advisors are being recruited with property lease management and housing market expertise. The new advisors are expected to be in post from December 2024.

73. **Operating framework.** A Te Kāinga Operating Framework has been developed and approved by the Te Kāinga Governance Board. The Operating Framework consolidates past Council decisions and offers a comprehensive document outlining the programme's intended operation. It includes the strategic context, policy framework, governance and management for the programme, as well as financial modelling, business rules for project delivery, tenancy management operational procedures, rent setting process and the review process for the Framework.

74. **Approvals process for new buildings.** Business processes have been established for the assessment and approval of new Te Kāinga deals. The process aligns with Council's Investment Delivery Framework (IDF) and has been endorsed by the Project Management Office (PMO). A two-stage approvals process requires that a preliminary business case receives Tier 3 approval before progressing to a detailed business case. The detailed business case includes details of the site, building design, commercial terms, and an overview of the financial modelling (including scenario and sensitivity analysis), affordability assesment, risks and benefits associated with the proposed project. The detailed business case must be endorsed by the Te Kāinga Governance Board, chaired by the Chief Planning Officer. Once endorsed the proposal must also be reviewed and signed by General Counsel, Chief Planning Officer and Chief Financial and Strategy Officer, before being presented to the Chief Executive for approval and signature.

75. **Financial model for evaluation and forecasting.** Two new financial models have been developed by PwC for the Te Kāinga programme. The Evaluation Model is used to model new proposals and for assessing existing forecasts. The model can be updated based on new information and assumptions as projects progress. This model allows for scenario analysis and sensitivity analysis of outcomes based on varied assumptions around headlease growth, rental assessment and growth as well as assumption around operational costs. The Forecast Model is updated quarterly incorportating reforecasts of rental growth, inflation and other operational cost changes for existing buildings and show the programme's financial position over the length of the leases. This allows for a clear picture of whether a building is forecast to break even, and if not what mitigations can be taken.

76. [redacted]

77. [redacted]

- [redacted]
- [redacted]

- [redacted]
- [redacted]

[redacted]

78. **Tenant design brief.** [redacted] A design brief has been developed and is being used to outline what Council wants to see in new buildings in relation their design and composition. Developers must respond to each item of the design brief and identify each in a specification document as part of the detailed business case in the approvals process for new projects.

79. **Contract management of new projects.** Regular Project Control Group (PCG) meetings are being held between Council and developer partners throughout the development phase of the two buildings under contract. The PCG meetings enable Council to take an active role in design decisions, and monitor programme progress towards timely delivery on target completion date.

80. **Levels of Service agreement with Legal team.** The Housing Development and Legal teams have agreed to operating principles, including escalation pathways, by way of a Levels of Service agreement. The agreement outlines the responsibilities of each team and how the teams will work together. Levels of service are based on the priorities of the Council, Chief Executive KPI's and risk to Council.

81. **Escalation process for issues.** A Managers Report is provided to the Chief Planning Officer each fortnight and outlines current and emerging risks and issues for the delivery of the programme. Any risks or issues considered material can be escalated by the Chief Planning Officer to the Chief Executive through their fortnightly reporting cycle.

82. **Operational reporting.** The tenancy management team provide an operational report to Manager Housing Development weekly, which includes detail of risks or issues, and includes updates on key programme metrics such as occupancy and demand/interest in the programme. Issues highlighted in this report are escalated as needed through the fortnighty Managers Report.

83. [redacted]

84. **Tenancy management improvements.** Te Kāinga tenancy management operations have been refined, including establishing a clear process for minimising rent arrears, reviewing data management processes, and creating a newsletter for regular communication with tenants. Key programme metrics are monitored weekly, including occupancy levels, demand for vacant apartments, any tenant issues and rent arrears.

85. **Mainteance process review.** The maintenance process has also been improved, to reduce the time it takes to respond to jobs. Since February, tenants can report issues directly to the building maintenance team as they arise. This has removed the Te Kāinga team as the middle step in the process, and means jobs are being attended to more quickly. This is an improvement in service, at no additional cost.

86. **Tenancy management expertise.** All Te Kāinga tenancy managers have completed a residential property management course through the Real Estate Institute NZ (REINZ). Learnings from this course have been incorporated into the operational processes for Te Kāinga.

87. **Tenant survey.** Te Kāinga tenants are surveyed annually to monitor satisfaction and their perception of value for money. Vacating tenants are also encouraged to complete an exit survey, so that we can understand their reasons for leaving. Feedback from these surveys supports the programme‘s continuous improvement.

88. **Tenant benefit programme.** An exclusive tenant benefit programme, Te Kāinga Plus, was launched in May 2024 to offer Te Kāinga tenants access to discounts and deals with businesses in Wellington. Te Kāinga Plus encourages tenants to use the city as their backyard. With Te Kāinga Plus, residents can enjoy discounts on city attractions and services such as bike hire from Switched on Bikes, deals on food and drinks at The Lab on Victoria Street, discounted car sharing with Mevo, discounted trips on the Wellington Cable Car, free wellbeing webinars from Telus Health and free child passes to Wellington Zoo. The range of Te Kāinga deals is expected to grow, based on feedback from tenants about the types of deals they would like to see included

Ngā mahinga e whai ake nei | Next actions

89. Officers will provide the third annual update to Audit and Risk Committee in November 2025.

Attachments

Nil