

**DRAFT RESTRUCTURE – SOCIAL HOUSING PORTFOLIO
HEARINGS PANEL
22.08.2014**

**A meeting of the Draft Restructure – Social Housing Portfolio Hearings Panel
was held in the No. 1 Committee Room
on 22 August 2014 at 10.36am**

PRESENT: Deputy Mayor Vicki Buck (Chair)
Councillors Phil Clearwater, Pauline Cotter, Glenn Livingstone, Paul Lonsdale and
Andrew Turner

APOLOGIES: Councillor Ali Jones

1. APOLOGIES

An apology for absence was received and accepted from Councillor Ali Jones.

An apology for lateness was received and accepted from Councillor Paul Lonsdale who arrived at 11.15am.

2. CONFIRMATION OF MINUTES

The Hearings Panel unanimously **decided** on the motion of Councillor Cotter, seconded by Councillor Clearwater, that the minutes of the Proposed Restructuring of the Christchurch City Council Social Housing Portfolio Hearings Panel of 8 August 2014 be confirmed subject to an amendment to 4.2.3 of the resolution to read as follows:

4.2.3 Intention would be to lease *some* Council housing to the entity in order to access the IRRS.

3. DELIBERATIONS

3.1 A staff memorandum dated 21 August 2014 was tabled (**Attachment 1**) addressing issues raised via Hearings Panel recommendations at the last meeting. Staff spoke to the common themes and issues.

The Hearings Panel adjourned at 1.06pm and reconvened at 1.45pm.

4. HEARING PANEL RECOMMENDATIONS

It was **decided** on the motion of Councillor Livingstone, seconded by Councillor Lonsdale, that the Hearings Panel:

4.1 Recommend that the Council adopt the following amended objectives as per the Statement of Proposal that in respect of the provision of social housing in Christchurch:

- Have more flexibility in the future ownership, management and development of the Council's own social housing portfolio.
- Ensure that the portfolio has a financially viable and sustainable future.
- Maintain the capacity to provide the current number of social housing units in the Council's portfolio and to act as a catalyst for the provision of additional units in the city.

And

- 4.2 The Hearings Panel recommends that the Council considers and ratifies the Housing Accord, modified to reflect the nature of the Council's contribution, and further recommends:
- 4.2.1 That the Council's contribution contained in the Housing Accord comprises up to \$50 million, from part of Council's social housing portfolio, over a number of years to be land, either bare or with units scheduled for demolition or intensification, from the social housing portfolio.
 - 4.2.2 That the Council takes immediate steps to clarify the issue arising from the cost sharing agreement with regard to the up to \$15 million internal transfer required back to the housing fund in respect of red zone property. Two options discussed by the Hearings Panel were rebate of development contributions on new social housing developments, and/or transfer of land currently not in the social housing portfolio.
 - 4.2.3 That the Council establishes an entity, as a not for profit organisation, to improve sustainability of social housing and security of tenants and also enable the entity to access the Income Related Rent Subsidy, and that any surplus is reinvested in social housing, or related facilities.
 - 4.2.4 That the intention would be to lease appropriate Council housing to that entity in order to access the Income Related Rent Subsidy but that leasing would not be able to in any way delay the repair and redevelopment of Council social housing. The lease agreement needs to protect existing tenants in regards to rent increases, security of tenure, terms of tenancy agreements, tenancy management, and ongoing relationships between staff and tenants.
 - 4.2.5 That any agreement be structured such that in the event of winding up, or withdrawing from the entity that Council assets are returned to the Council's social housing portfolio.
 - 4.2.6 That youth housing needs to be a priority. The Panel notes that this was identified as an important issue during the submission process.

And

- 4.3 The Hearings Panel recommends that the Council recognises that security of tenure is paramount.

And

- 4.4 The Hearings Panel recommends that staff be requested to report to the Housing Committee on:
- 4.4.1 Criteria for identifying suitable parties who may have a desire to be part of that entity and who are aligned with the objectives listed in 4.1 above.
 - 4.4.2 The objects of the company, constitution, head lease, tax implications, and any other documentation required to establish the entity including the existing lease arrangements.
 - 4.4.3 Clarifying the funding and steps to repair existing social housing units.
 - 4.4.4 Options for implementing a new rental structure for units outside the entity including addressing the current model of increases being linked to the Consumer Goods Price Index.

The Hearings Panel notes that the preferred option of the majority of the submitters was the Council's preferred option of leasing to a new community housing provider, but that the second preferred option of submitters was a capital injection to social housing from Central Government.

The meeting concluded at 3.57pm

**Christchurch City Council
Community Support Unit
MEMORANDUM**

DATE: 21 August 2014

FROM: Carolyn Gallagher, Unit Manager Community Support

TO: Hearings Panel for the Proposed Restructuring of the Council Social Housing Portfolio 2014

SUBJECT: Further Information as Requested by Panel on 8 August 2014

ATTACHMENTS:

- **Appendix A:** Potential structure for entities – option 1
 - **Appendix B:** Potential structure for entities – option 2
 - **Appendix C:** Simpson Grierson letter
 - **Appendix D:** Pricewaterhouse Coopers (PWC) letter
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PURPOSE AND ORIGIN OF MEMORANDUM

This memorandum has resulted from the resolutions passed by the hearings panel for social housing at their first deliberation meeting on 8 August 2014, relating to the future of CCC social housing.

The hearings panel endorses the Council's objectives as per the Statement of Proposal in respect of the provision of social housing in Christchurch is to:

- Have more flexibility in the future ownership, management and development of the Council's own social housing portfolio.
- Ensure that the portfolio has a financially viable and sustainable future.
- Maintain the capacity to provide the current number of social housing units in the Council's portfolio and to act as a catalyst for the provision of at least 1,000 additional units in the city.

The Panel passed the following resolutions and requested further information in relation to the preferred option (Option 1) to be reported back to the Hearings Panel on:

- 2.1 Exploring options for establishing a potential entity as a not for profit organisation in order that any surplus is reinvested in social housing, or community facilities for social housing.
- 2.2 Identify additional parties who may have a desire to be part of that entity and who are aligned with the objectives listed in 1 above.
- 2.3 Intention would be to lease Council housing to the entity in order to access the IRRS.
- 2.4 Council contribution contained in the Housing Accord. (Consideration of the \$50 million over a number of years intended to be land, predominately from social housing or a proportion of social housing but will look at other Council land to make up the \$15 Million internal transfer in respect of red zone property.)
- 2.5 Youth housing needs to be explored.
- 2.6 Legal constitutional and tax implications of entity.

- 2.7 Structure such that in the event of winding up, or withdrawing from entity that Council assets are returned to the Council's social housing portfolio.
- 3.0 The Hearings Panel recognises that security of tenure is paramount.

BACKGROUND

The Christchurch City Council is considering the Council's role in the provision of social housing, both in the repair and rebuilding of current housing stock and in future ownership and/or management structures.

In accordance with the requirements of the Local Government Act 2002, Council adopted a Statement of Proposal (SOP) to consult with the wider community. The Statement of Proposal included details of the proposal, the reasons for it and an analysis of the reasonably practicable options that are available to the Council.

Twenty eight consultation sessions were held over the period between Wednesday 21 May, 2014, and 5pm on Thursday 26 June, 2014. 199 City Housing tenants attended these sessions and 349 members of the wider community, including social housing stakeholders attended the sessions.

By the time the proposal closed on 26 June 2014, 478 submitters provided comment on the Proposal. This included 270 individual written submissions and 208 individuals who completed a form at the end of some of the submissions stating that they supported that particular submission.

Public hearings took place on Friday 18 July and Thursday 24 July.

A deliberation meeting was held by the panel on Friday 8 August, resulting in further information being requested to be provided to the panel.

INTRODUCTION

Currently the Council's social housing portfolio is operating at a level that in a year or two will be unsustainable. Rents will need to be increased significantly, or income obtained from an alternative source, for there to be any meaningful change short of a major restructuring.

Options for dealing with this have been identified and the views of the community sought. The Council's proposal, and the preferred option emerging from the consultation process, is that the Council leases the buildings comprising its social housing portfolio to an entity that would be eligible for registration as a Community Housing Provider (CHP).

The reason for this is that in 2013 the Government made a number of changes to the way social housing is provided in New Zealand. These are set out in amendments to the Housing Restructuring and Tenancy Matters Act 1992 and in the Housing Restructuring and Tenancy Matters (Community Housing Provider) Regulations 2014. The amendments introduce a new basis for the Government's contribution to rent paid by low-income qualifying tenants - the income-related rents scheme.

The scheme applies in respect of tenants placed in community housing owned or operated by a registered community housing provider. To be eligible for registration a provider must meet a number of criteria set out in the regulations, one of which is that it must not be a local authority, a Council-controlled organisation or the subsidiary of a CCO unless the subsidiary is operating at arms length from the local authority or CCO.

The current accommodation benefits paid in respect of existing social housing tenants provide the Council with income but only up to the level of rent received, which is about 50% of market rents. We estimate over 90% of our tenants currently receive an accommodation supplement. Under the income-related rents scheme the

community housing provider will be able to charge market rents and receive a Government "top up" for the difference between the rent payable by the tenant and the market.

The outcome is that registered community housing providers will be able to derive greater income from community housing than the Council currently can. However, the Council is not eligible for registration as a provider and can only benefit from the income-related rents scheme if it was to be part of an entity that was owned and operated at arms length from the Council. Indications from the Government are that if the Council owned 49% or less of the entity it would comply with this particular criteria.

The "do nothing" option would leave the Council exposed to a worsening financial situation. The proposal put to the community was that the Council establishes an entity capable of managing the Council's social housing portfolio as a registered community housing provider and then leases units to it for renting under the income-related rents scheme. It is proposed that once the entities are established the governance would have the responsibility for attracting external, independent parties that would be interested in taking a majority share of the entity, to the point where it would become eligible to apply for registration. In other words, the Council's interest would reduce to 49% or less, so that the entity would be at arms length from the Council.

Legal and financial advice provided to Council staff supports the establishment of the entity as a limited liability company. It has also been suggested that a holding company be incorporated in which the Council would hold all of the shares and which would in turn set up as a subsidiary the entity that would become a community housing provider. One of the reasons for this is that if the Council elects to become involved in the development of affordable housing, as currently contemplated in the Housing Accord, the holding company could establish another subsidiary to represent the Council's interests in this activity. The entity may also be used to manage the transfer and development of land currently used for social housing or other purposes.

The holding company does not necessarily need to be a company. It could be an establishment board or some other subordinate decision-making body of the Council. The purpose would be to delegate responsibility for decision-making to an entity in which the Council has control.

An important point to note is that the Council has yet to ratify the Housing Accord and to determine its role in providing affordable housing. Until it does, it is not appropriate for the Council's contribution under the Accord to be included in the deliberations of the hearings panel. This aspect of the issue was not included in the consultation undertaken in respect of the re-structuring of the Council's social housing portfolio.

With regard to the hearings panel's specific requests for information:

2.1 Exploring options for establishing a potential entity as a not for profit organisation in order that any surplus is reinvested in social housing, or community facilities for social housing.

One option is that 51% or more of the shares in the entity are held by an independent non-Council controlled Trust set up for that purpose. The Trust would not bring equity into the entity but instead would be a vehicle for providing the relevant expertise for managing the Council's social housing units under the proposed lease, if the entity was successful in becoming a registered community housing provider.

As always, the devil is in the detail but external legal advice has confirmed that this proposed structure is conceptually appropriate (see attached opinion from Simpson Grierson). Matters still to be addressed would include the control and governance of both the Trust and the entity, reflected in their constitution and trust deed. It will be important to ensure that no aspect of the ownership/governance arrangements would cause the entity to be a Council-controlled organisation. A stakeholder or stakeholders independent of the Council would need to be identified, either to act as trustee(s) of the Trust or to have the power of appointment/removal.

Also to be dealt with is the leasing arrangement. Financial information is provided elsewhere, but in broad terms the value of the income-related rents scheme should be around \$12 million per annum. If lease payments to the Council are, say, \$8 million there is potentially an annual profit to the Council of \$4 million, depending on how matters such as depreciation and maintenance are assessed. The terms of the leasing arrangement will be crucial in relation to protecting the Council's on-going interest (including retention of ownership in, or reversion of) the social housing units.

It is agreed by staff that the entity should operate as a not-for-profit organisation, re-investing any surplus from its activities into social housing or community facilities for social housing. One of the options that will be discussed with the Council in due course will be the possibility of that re-investment (maybe \$4 million per annum) being part of the Council's contribution to the development of social and affordable housing in accordance with the Housing Accord.

Proposed Structure

At the hearings panel, held on Friday 8 August, the panel requested "staff to explore options for establishing a potential entity as a not-for – profit organisation in order that any surplus is reinvested in social housing, or community facilities for social housing (for the purposes of clarification, staff have interpreted the term community facilities in this instance to relate to communal residents lounges, that pre-existed in 20 social housing complexes pre quake.

During the development of the Statement of Proposal for this process staff contracted Simpson Grierson to provide legal advice and legal review on the options contained within the SOP document. Further to this, Price Waterhouse Coopers (PWC) provided financial advice and review of these options, before the SOP was finalised and approved.

In 2013, the Government announced its Social Housing Reform Programme. The Housing Restructuring and Tenancy Matters (Community Housing Provider) Regulations 2014 came into force on 14 April 2014. The regulations include the criteria for the registration and management of non government providers (defined as Community Housing Providers) Local Authorities, Council Controlled Organisations and their subsidiaries (unless operating at "arms length") are not eligible for registration. The effect of this is that, although some current Council social housing tenants will still be paid the Accommodation Supplement, the Council (as landlord) would not be entitled to receive the Governments new rental subsidy (Income Related Rent Subsidy, IRRS)

This advice recommended the utilisation of a company structure rather than a trust based with the following points summarising the advice;

- A non-charitable trust structure would suffer from a number of the disadvantages identified in our table in respect of a charitable trust, but would not have the advantage of tax exempt status.
- More generally and as we identified in our table, a trust may not be a suitable vehicle for some commercial arrangements, and is not as flexible as other structures listed in our table, including the structure recommended in the statement of proposal.
- The Council could not appoint a majority of trustees, if the trust was to have registered community housing status. While there is a similar constraint on the appointment of directors of a company, the council can still own 49% of a company and thus retain a degree of control by preventing certain key resolutions involving a greater majority than 50% being passed.
- In the private sector, and possibly in some circumstances in the public sector, a housing trust (whether charitable or otherwise) may well be a suitable structure depending on a variety of factors. The key question for the council is what is the best form of structure in the particular circumstances outlined in the SOP.

Staff are continuing to work with PWC and Simpson Grierson to refine their advice as a result of the hearings panel recommendations. Therefore, for the purposes of this memo the following structures refer to entities, rather than predetermining an entity type.

In order to comply with the Social Housing Unit regulatory framework requirements, staff have developed a potential structure involving multiple entities that are at arms length to traditional and current Council social housing ownership and management.

These four entities are detailed below – please refer to Appendix A & B for a graphical representation of the structure of entities and how they are proposed to interact with one another.

Asset Holding Entity

An option for Council to secure control of the social housing assets and preserve tenant security is to establish an Asset Holding Entity. This entity would be established to hold the social housing assets (land, housing units, and communal residents' lounges) of the Christchurch City Council. The effect of transferring the assets from the CCC into this entity would not result in a loss of asset value from the Council balance sheet, as the entity value would reflect the asset base and the entity would remain an asset wholly owned by the CCC [refer to Appendix A]

The Asset Holding Entity would be involved in setting the direction of two operational subsidiaries beneath it, being the Community Housing Provider (operational entity) and the Housing Development Entity. The board could consist of a skills based governance structure, in addition to elected official appointments. The appointment of elected officials to this board could ensure Council are represented effectively in relation to the cities social housing, and continual oversight of the social housing assets.

The Assets Holding entity would own social housing land and buildings within this entity and would be leased to the CHP, allowing the CHP to operate as an effective and efficient Community Housing Provider, maximising its revenues through the introduction of Government subsidies. This structure is likely to demonstrate the representation of the social housing assets being at arms length from Council, officially ring fencing the social housing assets and any future potential revenue flow back to the parent entity/Council from the Community Housing Provider. Therefore, it would be expected this would meet the 49% / 51% split as a requirement of the Regulator.

Where assets require or offer re-development opportunities, they may be temporarily transferred to the Housing Development Entity, who would complete the redevelopment with the resulting housing products being transferred back to the Asset Holding Entity with a lease in place to the CHP.

This Asset Holding Entity could own 49% of the equity in the CHP and 100% of the equity in the Housing Development Entity. These two subsidiary entities would have their own governance structures.

Community Housing Provider (CHP)

The Community Housing Provider (CHP) would be set up by the CCC, with 49% of the equity being owned by the Asset Holding Entity and 51% initially being owned by the Housing Share Entity. Council can only own up to 49% of this entity due to the regulatory requirements in place relating to the access of Income Related Rent Subsidies and the ability to charge tenants an Income Related Rent. This is set out further in the Social Housing Reform Housing Restructuring and Tenancy Amendment Act 2013.

The CHP would operate akin to the current social housing management, however the main difference would be that it leases assets from the Asset Holding Entity and manages social housing tenancies and operations, to house those most in need.

When accreditation is achieved, the Company would then enter into a contract with the Ministry of Social Development, likely for one year term, with the ability for the contract to roll-over assuming accreditation is maintained. This contract would allow the CHP to charge tenants an Income Related Rent, set by Work and Income, linked to the tenant's income. This would mean that the rent charged

is an affordable rent. The CHP would receive Income Related Rent subsidies (top-up to market rent) from MSD paid directly to the CHP.

The CHP would in effect receive full market rents for the assets it manages; this would approximately double the rental revenues in comparison to how social housing operates under current Council management, this is due to Council charging a rent that is approximately 50% of market rent.

The CHP could pay all operational expenses relating to the management and operation of the social housing service, and contract the Council owned Housing Development Entity to complete large/medium capital upgrades to housing stock, and redevelopment where appropriate.

Initially any surplus would be reinvested into improving social housing quality and capacity within Christchurch, yet it is anticipated that this entity could reach a point in the future, where it is financially able to provide a small return on investment back to the parent entity/ Christchurch City Council, placing the portfolio in a position where it can not only pay for itself, but also provide a return on capital to ratepayers. Advice could be taken from the Independent Transactions Unit being set up by MBIE, who provide advice to the Government in relation to the return on capital from Housing New Zealand stock transfers/leases/asset sales to Community Housing Providers.

Housing Share Entity

The proposed CHP will initially be split into two ownership segments. One part is 49% owned by the CCC (through the proposed Asset Holding Entity) and the remaining 51% is owned by the proposed new Housing Share Entity.

The Housing Share Entity would be independent from Council completely. The entity would be set up to initially hold 51% of the shares of the CHP (the CHP only leases the Council assets, rather than owns) This arrangement would mean that immediately on formation of the CHP, the Council ownership is less than 50%, meaning that IRRS should be available immediately, rather than delaying the receipt of this subsidy as segments of equity are released/sold to equity partners to reach a point where the CHP is not a Council Controlled Organisation.

It could be a possibility that the appointment of a Central Government representative/s at a governance level for the Housing Share Entity in assisting to satisfy regulatory requirements relating to the CHP accreditation. This would give central government the ability to monitor and be involved in decision making of any future equity partners.

The benefits of this entity are seen as below;

- Independence from Council (in terms of expediting regulation and access to IRRS)
- Prudent Long Term Management
- Ability to sell down equity to organisations that align and can create economies of scale
- Allow a central government oversight
- Monitoring performance of CHP / Government Regulation
- May assist to facilitate accreditation of CHP

Housing Development Entity

This entity would be wholly owned by Council through Its the Asset Holding Entity and its primary purpose would be to upgrade social housing and work with private sector companies and contractors to develop brownfield and greenfield housing developments.

The entity could utilise Public Private Partnership (PPP) and Build, Own, Operate and Transfer (BOOT) models to create commercially viable housing projects, of which assets are then returned (or sold) to the Asset Holding Entity with a lease in place for the CHP to manage and operate as social housing.

It is anticipated that this entity should be able to operate in an agile and competitive manner to demand the best value from private sector contracts/investment.

Should Council elect to broaden its provision of housing to include affordable housing (rental or home ownership) this company would be an important vehicle to help achieve this goal.

Funding of this entity would need to be worked through and would need to be considered through the setting of Activity Management Plans in the Long Term Plan process.

Tax implications of this entity and how it interacts with other CCC entities would need to be considered, so as to not disadvantage any tax benefits the CHP may be able to achieve.

Based on this further level of detail and direction required, the differentiation between Appendix A & B shows this entity included and not included as options.

2.2 Identify additional parties who may have a desire to be part of that entity and who are aligned with the objectives listed in 1 above.

Potential Co-owners of the Community Housing Provider

In relation to the 51% equity holdings of the CHP, Council have options around how the selection of other equity co-owners occurs. Should the Share trust hold the 51% of these shares initially, Council would set the direction for the Trustees of the share trust to follow. It would be likely that a contestable process such as an Expression of Interest in the market be utilised, so as to promote a fair and transparent process. This would ensure the introduction of the most appropriate co-owners and alignment with the strategic vision of the Council, to achieve the desired housing and social outcomes.

2.3 Intention would be to lease Council housing to the entity in order to access the IRRS.

As outlined in the various entity structures above, the concept of leasing the assets has been taken into consideration and will form the basis of any future development of this proposal, including future discussions with the regulator.

This option would retain the asset ownership by the Council or by a fully owned Council entity, whilst passing only the management of the assets to the CHP to operate as a social housing provider.

2.4 Council contribution contained in the Housing Accord. (Consideration of the \$50 million over a number of years intended to be land, predominately from social housing or a proportion of social housing but will look at other Council land to make up the \$15 Million internal transfer in respect of red zone property.)

Council's social housing portfolio was reduced by 113 rental units to the residential red zone, with a 2007 Government Valuation of approximately \$15M. The resolution of the hearings panel referred to this land.

There is currently no Council resolution on any internal transfer of funds and this would result in a direct increase in rates.

2.5 Youth housing needs to be explored.

Youth Housing

The consultation process highlighted the issue of youth housing for youth who have left home and struggle to find accommodation. Vulnerable or at risk youth are facing a lot of housing competition from other young people and the construction workforce in a heated, unaffordable, rental market. There is a lack of options available for safe, secure suitable housing for them.

Agencies and organisations find it challenging to work with youth to help them meet their obligations around education and training, especially given that most education opportunities on offer mean that a central city focus for housing is required. If youth are not able to access affordable housing this then puts the work being done around education, training and budgeting help at risk.

Community organisations are finding that increasing numbers of young people are boarding with friends and/or family in unsuitable and/or expensive accommodation, sleeping rough, or couch surfing. Housing issues mean vulnerable/at risk youth putting themselves in unsafe situations regarding accommodation, so health issues can escalate. The feedback given to Council noted an urgent need for safe, secure housing that is well planned with the necessary support and security attached to it.

Staff have been involved in various discussions and multi-agency collaboration groups over a number of years, which hasn't address the needs for youth housing. Currently, Council's Housing Committee has asked staff to widen the search for a suitable piece of land to be made available for the Wayne Francis Trust (and others) to progress the development of a Youth Housing facility. Staff understand that there is external funding available to fund the building. The proximity requirements of this land, being close to the CBD and CPIT is proving challenging in terms of land availability.

There would be various ways in which the Council could support Youth Housing through future potential entities; one being the provision of land being made available by lease, gift or sale to a CHP who manages the Youth Housing facility. The other being for the facility and the land to be retained in by the Council (or it's asset holding entity) with the CHP managing the tenancy related aspects (receiving IRRS) and the skills based support services being contracted to another agency.

2.6 Legal constitutional and tax implications of entity.

Legal Implications

As noted by Simpson Grierson, the entity should qualify for exemption from income tax as a community housing provider, if its constitution appropriately covers off the requirements for exemption and other matters such as registration are met. Qualifying for this exemption would not preclude the entity from also being a charitable organisation but registration under the Charities Act 2005 would not be necessary to secure exemption from income tax.

At least 85% of the entity's beneficiaries/clients must fall within criteria set by the regulatory authority, which will include income and asset thresholds. The relevant eligibility requirements will need to be specifically covered in the entity's constitution.

For the exemption to apply the entity's activities must be predominantly for the provision of housing, with all profits retained (re-invested) by the entity or distributed or applied to its beneficiaries/clients and /or to other tax-exempt community housing providers or tax charities and/or for charitable purposes.

The Regulations referred to above set out a number of performance standards that would have to be met before the entity could be eligible for registration as a community housing provider. They include requirements for governance, management, financial viability, tenancy management, and property and asset management. These should be considered and reflected in the entity's constitution and any associated documentation. The standards would be reviewed annually by the regulatory authority.

Tax Implications

The tax implications relating to the proposed establishment of these entities needs to be further assessed.

Financial Implications

Current Financial Picture Compared to Option 1

Resolving the ongoing viability and financial stability of the social housing portfolio is an important matter and can't be rushed. However, there is time pressure caused by the current financial position of the portfolio. A comparison between the current financial operating model and that projected of a CHP gaining IRRS is outlined below.

Option 1: Lease land and buildings to a Community Housing Provider

Modelling information

Council retains ownership of the land and buildings and leases the properties to a CHP.

Under this option the CHP has a lease for up to 45 years and is responsible for all operational costs, maintenance and renewals (roofs/carpets etc) but not replacement of the buildings at the end of the lease. The CHP receives income equivalent to market rents and taking into account all of the costs mentioned above the CHP could afford to pay a rent of approximately \$8.6 million per year. This would leave the CHP with a small annual surplus.

The Government's Income Related Rental Subsidy (IRRS) can be accessed.

Financial Analysis:

Impact on Rates

The current Council approved policy is for Social Housing to be rates neutral. Therefore there would be no impact on rates if any surplus is used for other housing initiatives.

After applying the \$8.6 million income from the CHP to be set aside for replacement of stock, there would remain a surplus of \$3.8 million for Council consideration.

With a change in current policy, the surplus funds of \$3.8 million could be applied to other Council activities – potential rates reduction of 1-1.15% over life of lease.

Applying the \$3.8 million annual surplus to borrowing reduces debt by \$45 million in the first 10 years.

Impact on Council

Council's rental income equates to a return on investment in land and buildings of 2.5%.

With a change in current policy, Council could use the rental receipts:

- To create a fund to pay for the replacement of the portfolio at end of lease and the surplus of \$3.8 million is used for other housing initiatives.
- Create a fund to pay for the replacement of the portfolio and the surplus \$3.8 million is used to fund operational activities this will reduce rates by approximately 1-1.15% per annum.

- Create a fund to pay for the replacement of the portfolio and the surplus \$3.8 million per annum is used to reduce debt; this will reduce the Council's projected maximum debt by \$45 million in the first 10 years.

Risks

Replacement of buildings costs more than expected at the end of the lease

Council retains the risks of ownership and operation of the social housing activity, although these are minimised by the terms and conditions of the lease.

A peer review of the Social Housing modelling is still to be undertaken which may result in changes which will amend the impact to ratepayers and Council.

Recommended Option

Additional government subsidies can be accessed.

Potential to reduce Council's borrowing and/or operational costs to reduce rates requirement.

Council will have sufficient funds in the Housing Fund to fund the replacement of the buildings at the end of the lease.

Effect on Tenants

High level financial modelling on generic tenant profiles has demonstrated that many tenants will pay a lesser rent under an Income Related Rent model, than they are currently paying to Council. There appear to be some exceptions to this, for example a couple, both receiving New Zealand Superannuation would pay slightly more on an Income Related Rent than they currently do to Council. This is due to them having a relatively higher income (compared to a single person on a job seekers allowance for example) and their ability to afford a rent that is higher than they currently pay to Council.

3.0 The Hearings Panel recognises that security of tenure is paramount

There are some mechanisms Council could consider in relation to security of tenure. The first being to direct the CHP policy around how it becomes involved in the 'reviewable tenancies' process operated by MSD. This process is a review for those tenants who earn sufficient income that they are paying market rent (i.e., they are no longer entitled to a subsidy due to asset/income levels) Staff understand that there is no compulsion for CHP's to exit these tenants from their homes and it would be subject to the policy direction of the individual CHP.

The second mechanism would be for staff to further explore any opportunities to 'grandfather' existing rents, potentially for a period of time. This could ensure no tenant is 'worse off' if their tenancy is moved to a new entity. Staff would need to further discuss this with MSD, in terms of how this could operationally take effect and what options could be possible.

2.7 Structure such that in the event of winding up, or withdrawing from entity that Council assets are returned to the Council's social housing portfolio.

The terms of the leasing arrangement between the Council and the entity will be important with regard to protecting the Council's ongoing interest in its social housing portfolio. Restrictions would apply to the activities undertaken by the entity and to the distribution or application of assets and/or profit, including upon winding up. This would also be necessary for the entity to qualify for tax exemption as a community housing provider. Any organisation with an interest in the entity and

having some control over its activities must not be able to direct or divert, to its own benefit or advantage, any amount derived from those activities.

During the formation stage, consideration needs to be given to liquidity events including potential sell-downs from the CHP to new or ongoing partners, shareholder exits, and potential impacts of policy changes in the future. Option flexibility should be preserved around these matters during formation of the entities wherever possible.

STAFF RECOMMENDATION

It is recommended that the hearings panel;

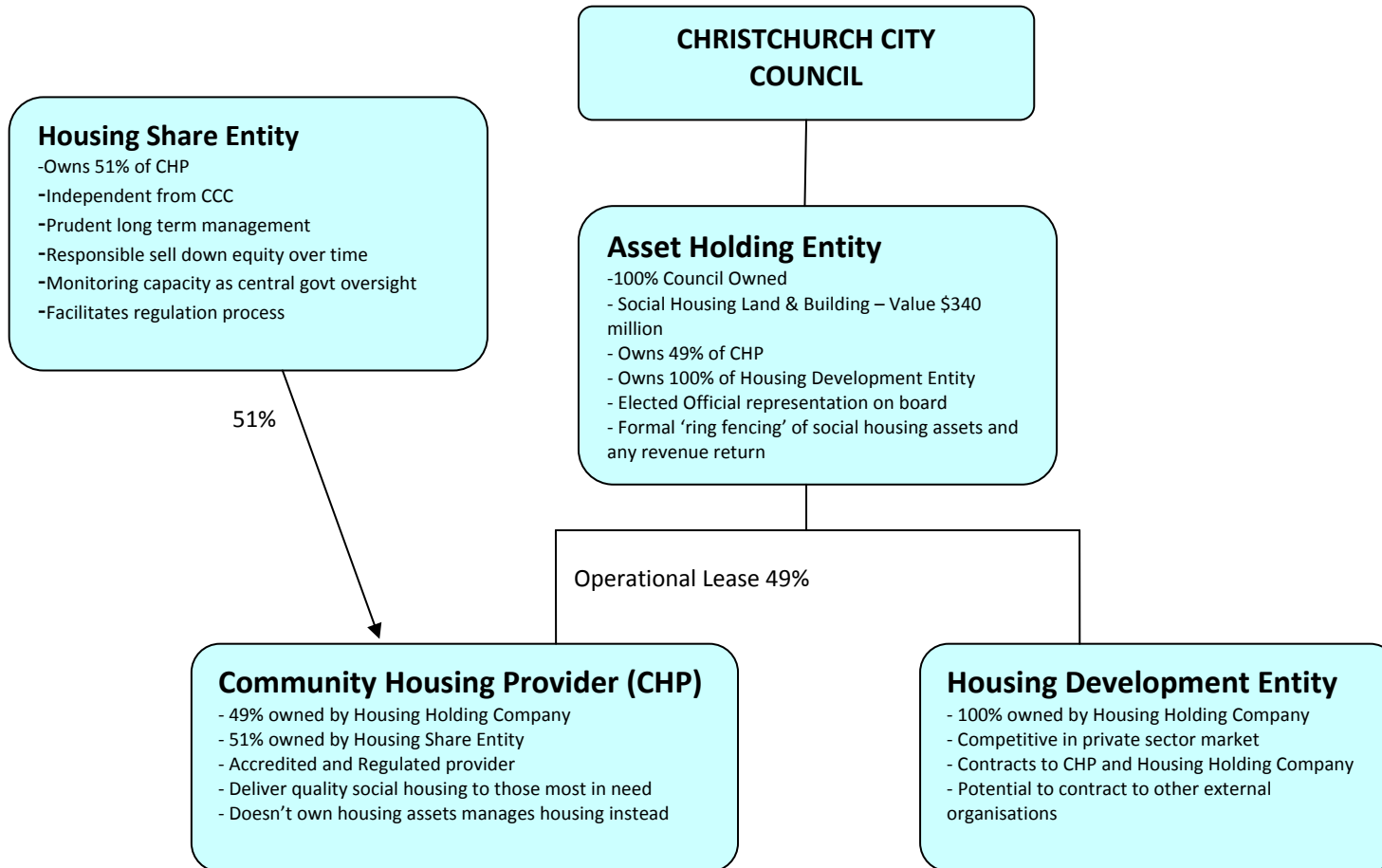
- Instruct staff to engage with the Regulator of Community Housing to ensure this model would satisfy accreditation and regulation principles and report this to Council.
- Instruct staff to develop options for Governance Structures and decision making models for respective entities.
- Adopt this model of operation and recommend to Council the creation of the four entities as detailed in this report (provided this model will meet regulatory and accreditation requirements)
- Instruct staff to seek advice from Ministry of Social Development and report to Council, in relation to operational arrangements that could be available to 'grandfather' current tenants rent, ensuring that existing tenants will not be will not be disadvantaged under an income related rent model.
- Instruct staff to gain confirmation from Central Government that an exemption for this CHP will be made available to be able to access Income Related Rent Subsidies for all existing tenants, rather than just new tenants taken from the MSD wait-list. Staff to report this information to Council.

Yours faithfully,

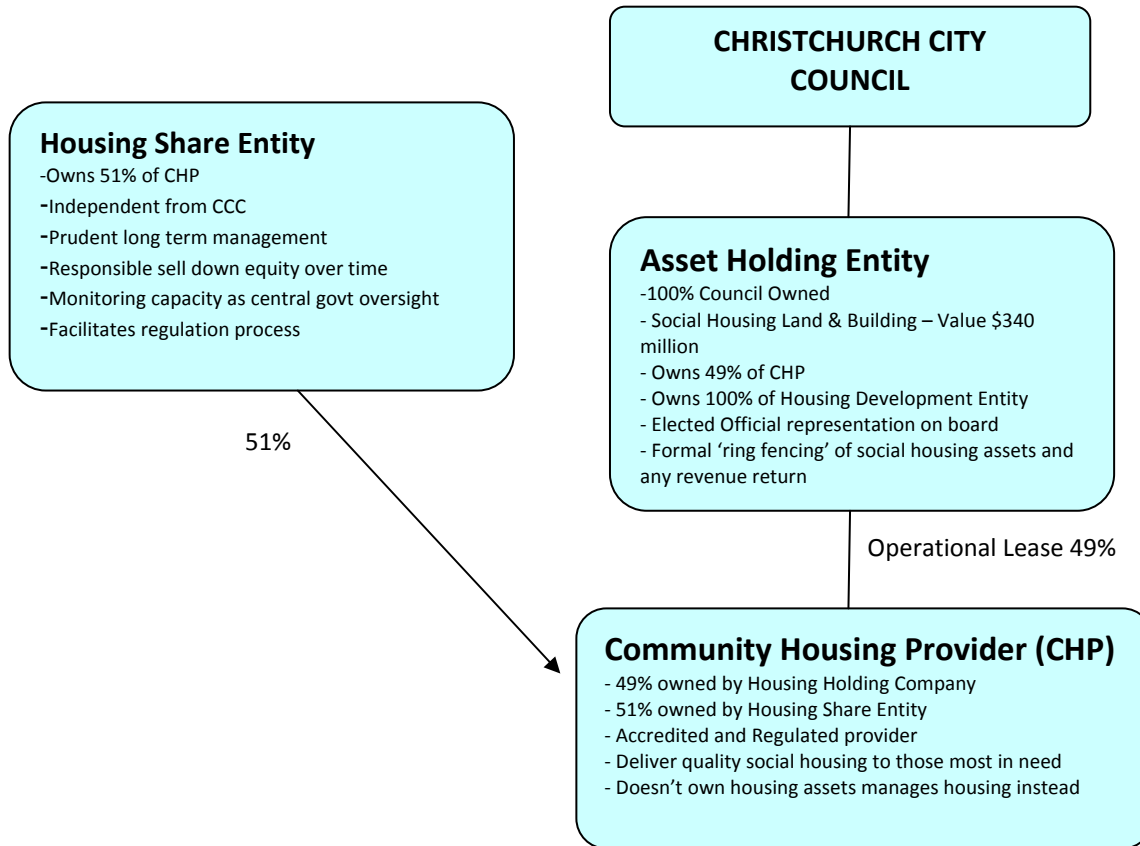


Carolyn Gallagher
Unit Manager Community Support

Appendix A: Potential structure for entities – option 1



Appendix B: Potential structure for entities – option 2



19 August 2014

Partner Reference
Jonathan Salter - Wellington

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For: Ian Thomson

Proposed Community Housing Provider to Deliver Social Housing – High Level Comments

1. You have asked us to set out high level comments on certain aspects related to the Council's preferred structure for the future delivery of social housing in the Council's district. In particular, you have asked us to comment on:
 - (a) structuring and income tax issues; and
 - (b) qualification to provide Income Related Rent Subsidy (**IRRS**); to eligible tenants under section 92 of the Housing Restructuring and Tenancy Matters Act 1992 (**HRTMA**).
2. The purpose of this letter is to summarize our comments on both of the above issues which were separately addressed in more detail in previous memoranda.

Background

3. As part of its social housing project, the Council proposes to establish a company to manage the Council's existing social housing portfolio.
4. The Council's preferred structure involves the establishment of a new "community housing provider" that would be a limited liability company incorporated under the Companies Act 1993 (**CHP Company**). The CHP Company would be owned by a new council controlled organisation (**CCO**) as a holding Company (**Holding Company**) as to a maximum of 49%, and by a new non-CCO trust (**Trust**) as to at least 51%.
5. The intention is that the CHP Company would be a registered community housing provider that would qualify to provide the IRRS to eligible tenants under section 92 of the HRTMA. Neither a local authority nor a CCO is eligible to be a registered community housing provider that can provide IRRS. Consequently the CHP Company must not be a CCO.
6. A subsidiary of a local authority or a CCO *might* qualify for registration as a community housing provider, but only if it is operating at arm's length from the local authority or the CCO. Such a subsidiary would be a "council organisation" (**CO**) as defined in section 6 of the Local Government Act 2002 (**LGA 02**) and we briefly discuss the implications of this below.

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Summary

General Comments

7. We confirm that the Council's preferred structure is conceptually appropriate. At present, it is not possible for us to confirm that the structure will work in practice, because of an absence of detail regarding the control and governance of the entities making up the proposal, their governing documents (constitutions and/or trust deeds) and the leasing arrangements.
8. There are some areas of risk that *might* impact on the ability of the proposal to work in practice. These are largely related to the detail of how the CHP Company is set up and its ownership/governance arrangements. These risks can be minimised by ensuring that the CHP Company is not set up as a CCO, that its constitution addresses appropriate matters, and that it operates at arm's length from the Council and the Holding Company.
9. We recommend that the constitutions for the Holding Company and CHP Company be prepared and discussed with the Ministry of Business, Innovation and Employment (**MBIE**) as a priority to ensure that they satisfy the relevant requirements. It is also critical that the Trust is set up as soon as possible and any third party stakeholders involved in its formation (or the use of an existing organisation if that is to be considered) are identified at the earliest opportunity. We also recommend that work to prepare a draft lease between the Council and CHP Company is also started.

Initial Structuring and Tax Comments

10. The absence of details in relation to the control/governance of the Trust that is to act as the majority shareholder of the CHP Company is a gap that needs to be filled. We understand that it is intended that one or more stakeholder organisations with an interest in the Christchurch social housing sector will be identified for this purpose. It may be feasible for that party or those parties to hold shares in the CHP Company directly, rather than via the Trust, but we assume the Council wishes to have a degree of influence (albeit not control) with respect to the other stakeholder(s) in the CHP Company.
11. In order to ensure that the CHP Company is not a CCO, in addition to the Trust not being council-controlled and the Holding Company's shareholding in the CHP Company being capped at 49%, it will be necessary to ensure that no other aspect of the ownership/governance arrangements for the CHP Company would cause the CHP Company to be a CCO, and the constitution for the CHP Company will need to be drafted accordingly. This includes arrangements relating to director appointments and also matters to be decided by special resolution of shareholders.
12. It would be optimal for the CHP Company to be exempt from income tax on its income. The CHP Company can be structured so that it will be fully exempt from income tax on its income. Because of its focus on social housing, the CHP Company should qualify for exemption from income tax as a "tax charity" and/or as a "community housing entity", provided that the constitution for the CHP Company appropriately covers off the requirements for exemption and that registration and other requirements are met.
13. Our initial view is that the new community housing entity exemption would be the obvious and best option for the CHP Company. (Qualifying for this exemption would not preclude the CHP Company from also being a charitable entity if this is considered appropriate, but registration under the Charities Act 2005 would not be required for this purpose or to secure exemption from income tax.)

14. If the CHP Company is structured so that it is fully exempt from income tax under one or other of the exemptions referred to above, monetary gifts to the CHP Company will also qualify for tax incentives, ie tax credits for individual donors and concessionary tax deductions for corporate donors. Local authorities and corporate CCOs can claim concessionary tax deductions for their donations to qualifying donees in appropriate circumstances.
15. The terms of the leasing arrangements between the Council (as landlord) and the CHP Company, and/or any funding arrangements between the Council and the CHP Company will be crucial in relation to protecting the Council's ongoing interest in (including retention of ownership in, or reversion of) the social housing portfolio. Care will, however, need to be taken to ensure that those terms do not impact on the CHP Company meeting the specific requirements that will apply for it to be a non-CCO and exempt from income tax.

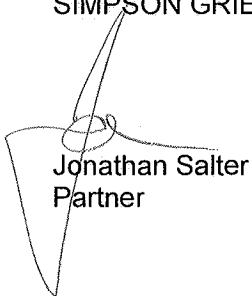
Qualification for IRRS

16. The ability of the CHP Company to qualify to provide the IRRS is dependent on the Company being set up in a manner that satisfies the relevant criteria in the HRTMA and its Regulations. In particular, to qualify to provide the IRRS the CHP Company must successfully apply for registration as a community housing provider *Class 1: social housing*. Following approval, under section 166(4) of the HRTMA, it will be eligible to receive IRRS from the Crown.
17. The authority that considers the application for registration (Community Housing Regulatory Authority (**Authority**)) has a discretion whether or not to register a community housing provider, but at a threshold level, the CHP Company must:
 - (i) Ensure that its application complies with Part 10 of the HRTMA;
 - (ii) Ensure that it is a community housing provider (which it should be able to satisfy provided that its constitution confirms that its objects include the provision of social and/or affordable housing);
 - (iii) Satisfy the Authority that it operates at arm's length from the Council and the Holding Company (being a CCO of the Council);
 - (iv) Ensure its directors have considered the relevant performance standards and support the application for registration;
 - (v) Satisfy the Authority, on reasonable grounds, that it has the capacity to meet the performance standards.
18. Provided that the CHP Company is established with the appropriate objects, that the Council and the CHP Company enter into appropriate arm's length arrangements for the CHP Company to lease and manage the social housing portfolio, and the Authority approves an application from the CHP Company to become a registered community housing provider, the existing social housing portfolio will become community housing for the purposes of the HRTMA and the CHP Company will qualify to provide the IRRS.
19. As the ability to qualify to provide IRRS is dependent upon satisfying requirements for registration that are dependent upon the objects of the CHP Company, and its independence from the Council and the Holding Company, it is not possible for us to confirm at this time that registration is likely to be granted. However, provided that the matters set out above are adequately addressed in the formation of the CHP

Company, its constitution, and any resulting lease between the Council (as landlord of the social housing portfolio), then in principle registration should be achievable.

20. To minimise any risk that registration may not be achieved, we recommend that a draft constitution for the CHP Company is prepared, and the constitution and structure of the arrangements is discussed with MBIE at the earliest opportunity.
21. We note that the CHP Company will be a CO. This means that Council's performance monitoring obligations in section 65(1) of the LGA 02 will continue to apply. However, the provisions in Schedule 9 of the LGA 02 relating to the transfer of undertakings will not apply. We assume that this will not be an issue as the basis of the arm's length relationship will primarily be managed by leasing arrangements.

Yours faithfully
SIMPSON GRIERSON



Jonathan Salter
Partner



Carolyn Gallagher
Christchurch City Council
PO Box 73049
Christchurch 8154

20 August 2014

Social Housing Portfolio - Panel Response

Dear Carolyn

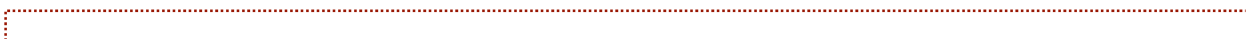
You have asked us to comment on your response to the Social Housing Hearings Panel following their resolutions on Friday 8th August, 2014, including a concept structure for how the Social Housing Portfolio could be structured to meet the requirements of obtaining the IRRS under current legislation. Your response follows on from the Hearing Panel's endorsement of 'Option 1' in the *Statement of Proposal that the Council Restructures its Social Housing Portfolio* and a series of matters for further information raised by the Panel on 8th August.

We believe the overriding purpose of this work is to obtain an outcome which is in the best interests of the current and future social housing tenants. This is to be achieved by retaining flexibility in the ownership and management of the housing portfolio and ensuring a financially viable and sustainable future for the assets.

Practically, this means obtaining a government rental subsidy (the IRRS) and using the increased revenue to cover the increasing operating costs and repairs and maintenance of the housing stock.

Our high level comments on your response to the Hearings Panel are as follows.

1. We support that the Council's preferred structure is conceptually appropriate. A number of key issues will need to be worked through in order for the structure to work in practice.
2. A number of tax and legal matters will need to be worked through in detail once approvals to move forward with the preferred option are given. Ownership and government subsidy of the Social Housing space is a developing area of public policy and tax advice (due to recent regulatory changes) and careful consideration needs to be given to the details of the proposals.
3. A mutually acceptable solution around the proposed entities, their ownership, and their governance, will need to be worked through with the regulator and funder (the New Zealand Government, the respective Ministries, and any other third parties). Predetermining the exact structures that will be required is difficult at this point in time.
4. The sequence and process for advancing the proposal and obtaining the IRRS is likely to be:
 - a. Determine which agencies need to be consulted with and what approvals processes will be required.





- b. Working through the details of an acceptable solution to Council, Central Government, and other necessary stakeholders and documenting the solution (entity formation documents, lease arrangements, and other legal documents).
 - c. Obtaining final approvals from Council and Central Government to establish the entities and put in place their governance and operating structures.
 - d. Forming the new entities.
 - e. Executing the rollout and operation of the ongoing social housing service.
5. The Council concept structure assumes the CHP entity is non-tax paying. Tax exempt status and the impact on potential net revenues will need to be worked through as part of the structuring process.
6. We note that the potential 'surpluses' which could be set aside under Option 1 include a figure of \$8.6m which we understand is, effectively, the depreciation on the buildings. How this money is treated, and where it is held, needs to be worked through as part of the structuring discussions.

We have not further analysed Council Staff's financial figures as part of our engagement.

This comment does not, nor is it intended to, result in either the expression of an audit opinion nor the fulfilling of any statutory audit or other requirements.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'M. Harrington', with a long horizontal flourish extending to the right.

Murray Harrington
Partner

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