

**MEETING OF THE BOARD
OF HOUSING NEW ZEALAND LIMITED
17 DECEMBER 1998**

WAIRARAPA COMMUNITY TRUST

ORIGINATOR: MANAGER – PRIVATE FINANCE INITIATIVES

1. Purpose

The purpose of this paper is to seek Board approval to sell all housing stock in the Masterton Neighbourhood Unit to Trust House Limited, a charitable company owned by the Masterton Licensing (Charitable) Trust and the Tararua Foundation.

2. Introduction

Housing New Zealand's ownership of substantial housing stock has led to various inefficiencies, for example, lack of liquidity in the portfolio preventing Housing New Zealand from responding adequately to changing customer demand (ref. LEK Partnership (NZ) Ltd report, December 98, page 27). Furthermore, Housing New Zealand does not appear to be achieving economies of scale advantages through its' single landlord status, with property management costs being higher than in the private sector.

The Board has been briefed at previous meetings on the possibility of selling the housing stock in the Masterton area, where, due to a low level of unmet housing need, it is not necessary for Housing New Zealand to provide rental accommodation.

Housing New Zealand has progressed negotiations with Trust House Limited to a point where approval is now sought for signing the Sale and Purchase Agreement. Subject to consideration by Shareholding Ministers, Trust House Limited would like to announce this purchase as an extension of their existing community interest on 18 December 1998.

The negotiated sale price is \$11.5 million, which will realise \$1.3 million for the Government. This translates to approximately \$19,000 per unit. An Independent Valuation report produced by Darroch Limited indicated a sales value ranging from \$8.7 million to \$12.7 million. The 'per unit' value will allow the Trust to offer a proxy 'Home Buy' programme. A covenant on sales for five years will cover Housing New Zealand against the Trust realising immediate profits from vacant sales. Housing New Zealand has sold properties in a similar manner in Dannevirke and, more recently, Kea Place (Wanganui), although these sales were not of tenanted properties.

A covenant set out in the Sale and Purchase Agreement requires Trust House Limited to provide access to rental accommodation for those in need. These services are to be provided in a manner which not only reflects its obligations to its Shareholding Trusts, but also contributes to the social needs of the communities in which the purchaser is involved.

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A communication strategy has been developed by Saunders Unsworth to identify and mitigate risk associated with the announcement on 18 December 1998. Following the announcement, Housing New Zealand will mitigate short to long term risks in three distinct phases. The first is the due diligence phase, due to finish on 1 February. The second will be a 'working partnership' phase, where Housing New Zealand will work alongside Trust House Limited to advance their knowledge. The third phase will involve developing Housing New Zealand's access facilitation role to monitor the provision of housing in the area to ensure that people with urgent housing needs are housed.

3. Sale Portfolio

The sale encompasses all properties owned by Housing New Zealand in the area covered by the Masterton Neighbourhood Unit, which extends from Dannevirke in the north to Featherston in the south. Housing New Zealand owns 576 properties in this area, which are broken down as follows:

Location	No. of Properties
Carterton	8
Dannevirke	86
Eketahuna	4
Featherston	15
Greytown	9
Martinborough	5
Masterton	406
Pahiatua	37
Woodville	6
Total	576

The houses comprise a mixture of mainly two and three bedroom properties of single level design, constructed mainly with weatherboard exterior sheathing and concrete tile roofing. Most of these properties were constructed between the late 1930's and the 1980's. The land associated with each house and locality is generally a standard surveyed lot ranging in size from 650 to 1000 square metres.

Rental market

The Tararua and Wairarapa region is one of the slowest growing areas in New Zealand, with population reduction noted in Tararua, Carterton and South Wairarapa districts between the 1991 and 1996 census. Statistics New Zealand have projected that this negative or low growth rate will continue for the next ten to twenty years.

In 1996, 22.7% of households in the Wairarapa and Tararua regions rented their accommodation. Housing New Zealand has 11% of the rental market in this area (compared to 17% nationally).

Darroch's valuation report states that between the 1986 and 1996 census, annualised real increases in residential rentals ranged from 4% in Masterton to 5.8% in South Wairarapa.

More recently the rental market has been flat with Housing New Zealand reducing rents by an average of \$5 (per week) during the recent rent reductions.

Average rents for these properties range from \$73.51 for one bedroom properties to \$114.77 for four bedroom properties. This compares favourably with the private sector.

No. of Bedrooms	No. of Properties	Current Rent
1	39	\$73.51
2	189	\$97.22
3	300	\$102.54
4	46	\$114.77
Other	3	\$65.00

Sales Market

Housing New Zealand sales over the last five years were as follows:

Year	Home Buy	Vacant Sales	Total	Average Sale Price/Unit	
				Home Buy	Vacant
98/99 YTD	5	35	40	\$37 600	\$35 100
97/98 *	22	93	115	\$39 500	\$30 400
96/97	4	73	77	\$39 375	\$34 500
95/96	12	20	32	\$48 800	\$40 700
94/95	2	1	3	\$32 250	\$15 000

* Group Sales in Dannevirke contributed to the higher vacant sales figure

Information provided by Darroch Limited states that for the year ending September 1997 there were 390 residential property sales in Masterton and 55 in Dannevirke and for the year ending September 1998 there were 377 sales in Masterton and 67 in Dannevirke.

Darroch Limited have indicated that a gradual sell down of the 576 properties in the area would take approximately five years.

Typical recent market sales prices in the various locations are as follows:

Pahiatua and Woodville:	\$22,000 to \$27,000
Featherston, Martinborough and Carterton	\$47,000 to \$57,000
Masterton Central and West	\$22,000 to \$37,000
Dannevirke	\$17,000 to \$25,000.

Vacancy Details

There are generally few properties vacant and available to let in this location, as it is an area targeted for aggressive reconfiguration, due to the low level of unmet housing need in the area. The breakdown of the status of houses in the Neighbourhood Unit is as follows:

Status	Count
Let	529
Vacant, available to let	2
Vacant, under consideration for sale	41
Vacant pending development	5
Total	576

It is Housing New Zealand's intention to withdraw properties from the market that are currently on the market following the signing of the Sale and Purchase Agreement. Trust House Limited will then take responsibility for letting or selling these properties following settlement on 1 March.

4. Tenant Detail

The Wairarapa initiative includes 529 tenancies:

- It is estimated that 60% of the customers are in receipt of some form of support from Work and Income New Zealand. Housing New Zealand records indicate that the tenants in this area are predominantly of New Zealand European or Maori ethnicity.
- The tenancies have a monthly annualised tenant turnover of approximately 30 to 45%. A summary of customer tenure shows 41% have been Housing New Zealand customers for one to four years, 15% for between five and nine years and 8% for over ten years. Only 15% of the customers have been in their homes for less than one year.
- Priority demand is very low in this area, with 2 priority applicants currently on the waiting list and only 3 top priority and 15 priority applicants registered in the 1997/98 year. In addition, there are currently 75 non-priority applicants on the waiting list whose needs are being met by their existing housing, this includes ten Housing New Zealand customers who wish to transfer to an alternative home.
- There are fourteen customers who receive the 55+ rent protection. Trust House Limited have agreed to continue with this rental discount. In addition, there are 66 tenure protected customers who will continue to receive the same level of protection.
- There are 22 modified properties which have amenities for those in wheelchairs and with other special needs. Trust House Limited have agreed to continue to supply these houses to customers with special needs, as required.

- There are 19 active Home Buy applicants who will be managed on a case by case basis, depending on their progress through the programme. Trust House Limited are committed to providing a similar tenant purchase programme.

5. Strategic Position

Housing New Zealand has identified areas where the private market is capable of providing housing without Housing New Zealand ownership or management. In these locations, Housing New Zealand can meet its obligations under the Statement of Corporate Intent by taking on a monitoring and facilitation role. This decision is supported by financial analysis (FAM) which indicates an investment value of \$10.2 million.

The recent work completed by LEK Partnership (NZ) Ltd identified the Masterton Neighbourhood Unit as an area of low liquidity, where a low level of housing assistance is required. LEK's recommendation was to "consider transfer of assets into leveraged property management trusts in rural communities" and that "Housing New Zealand should continue with its trust pilots (particularly the Masterton model)".

This sale is an opportunity to make further in-roads into the Company's reconfiguration strategy. The properties in the Masterton Neighbourhood Unit are in low demand. Housing New Zealand does not need to maintain ownership of housing in these locations where private providers will be perceived to provide a better level of service than Housing New Zealand.

This is not an isolated or opportunistic initiative, it forms part of the overall strategy. Initiatives in Wanganui and Porirua with local community interests are progressing rapidly, with further communities, such as Invercargill and Oamaru, showing a high level of interest in community ownership of housing.

6. Summary of Terms

The Sale and Purchase Agreement is based on the standard Real Estate Institute of New Zealand and Auckland District Law Society Sale and Purchase Agreement.

The key points added by way of special conditions are:

- The Purchaser acknowledges Housing New Zealand's social responsibility obligations namely: to be a responsive member of the community; to take account of local interests in maintaining and planning rental developments; and to operate in a manner that maintains a positive public image.
- The Purchaser intends to honour tenancy agreements and to facilitate access to rental accommodation to those in need.
- Consistent with social needs, the Purchaser will enable tenants to purchase individual properties.

- ❑ The Purchaser covenants with the Vendor that it will not sell any more than ten properties per year, excluding those sold to their tenants, for five years.
- ❑ The agreement is conditional on the Purchaser completing due diligence (by 1 February 1999).
- ❑ The agreement recognises that Housing New Zealand is still completing sales to customers through the Home Buy programme.
- ❑ Limited warranties, primarily the vendors responsibility to discharge debts and liabilities, carry on reasonable management and provide two staff members up to the point of settlement. The vendor will also account for any money received from the tenants following possession.
- ❑ The Agreement is for 576 properties with an adjustment on a Pro Rata basis for properties sold between the agreement date and the settlement date. This is a outright sale with no lease, management or maintenance obligation from Housing New Zealand.
- ❑ The purchase price is \$11.5 million
- ❑ The net book value is \$10.2 million

A copy of the agreement is attached in Appendix 1.

7. Profile of Purchaser

The proposed purchaser is Trust House Limited, a charitable company owned by the Masterton Licensing Trust (80%), the Tararua Foundation (19%) and the Flaxmere Licensing Charitable Trust (1%). In a 1997 reorganisation, the assets of the Licensing Trust and the Foundation were transferred to Trust House Limited, in return for a proportional number of shares. At the time of transfer, the assets were valued at \$8 million for the Licensing Trust and \$2 million for the Tararua Foundation.

The Licensing Trust was formed over 51 years ago, as part of a wider move to give certain communities control over the sale of alcohol. The Trust's main business was the retail and wholesale provision of alcohol in the Masterton area and it developed an extensive network of hotels, restaurants and wholesale outlets throughout the Wairarapa. It has outlets in almost all the communities that may be affected by the purchase. In recent years, it has expanded into care of the elderly and ownership of the community store in Eketahuna, as well as owning a bar in Wellington. Under the 1997 reorganisation, grants are made by the Masterton Licensing (Charitable) Trust.

The Tararua Foundation was formed in 1985 on the initiative of the Licensing Trust and brings together representatives of the major funding bodies in the Wairarapa to ensure a coordinated approach to the support of charities in the area. Until the 1997 reorganisation it held a similar, but less extensive portfolio of assets to the Licensing Trust.

Both the Licensing Trust and the Tararua Foundation provide grants to the local community. In inflation adjusted terms, the Licensing Trust has given \$3.8 million to the

local community since it was founded and the Tararua Foundation has given \$1 million. Their combined distribution in 1996/97 was \$313,400.

The Trustees of the Licensing Trust are democratically elected every three years. Three Trustees of the Tararua Foundation (the Mayor of Masterton District Council, a Masterton Licensing Trust appointee and the Chairman of the Masterton Trust Lands Trust) are automatically appointed to the Foundation and, in turn, appoint a further three members from the community to the Foundation's Board.

The combined operating profits for these entities were \$543,703 in 1996/97 and \$1,376,969 in 1997/98. Trust House Limited had a return on investment of 13.9% in 1997/98. It employs just on 400 people and is one of the Wairarapa's major employers.

Surveys commissioned by Trust House Limited show that they have a very good image and strong support in the communities in which they operate.

8. Administration Arrangements

Trust House Limited will manage the properties using one existing Housing New Zealand staff member and a further staff member who they will employ following settlement. This will equate to an average property portfolio of 290 units per full time equivalent. Some administrative functions will be absorbed by their existing structure.

It is Trust House Limited's intention to operate from their existing offices in Masterton.

Housing New Zealand will assist Trust House Limited in developing IT arrangements for managing the portfolio during the first few months of their ownership.

9. Financial Assessment

Valuation of Portfolio from Darroch Limited

Underlying Asset Value	\$12.7 million
Capitalisation of Net Income	\$ 4.5 million
Discounted Cash Flow	\$ 8.8 million
Realisation - 5 years	\$12.1 million
Realisation - 10 years	\$12.6 million

10. Risk Assessment

An initial risk is how well the announcement of the sale is received. This risk will be managed through the smooth delivery of the announcement to key stakeholders in the Masterton area, which includes local MP's, Mayors, media, staff, customers, contractors, sales agents, and others. A communications strategy prepared by Saunders Unsworth covers off these matters (see Appendix 2)

Community Impacts

There are three main impacts:

- The purchase will double the asset base of the purchaser (approximately) and substantially increase their ability to distribute grants to the community through the shareholders' charitable outlets.
- A substantial amount of money (rent minus local administrative and maintenance costs) that would have returned to Central Government will be retained in the Wairarapa area, to the betterment of the local community.
- The major local landlord will be community owned.

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Trust House Limited does, however, have extensive experience of both property management and running customer-oriented organisations.

Political Impacts

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Customer Impacts

Impacts on the customer depend on two things, namely the skilful management of the transition from one landlord to another and the future behaviour of Trust House Limited as the new landlord. The intention of both Housing New Zealand and Trust House Limited is to manage the transition well and to ensure customers will notice no negative change as a result of the sale.

There are a number of practical issues that will be resolved, for example.

- About 60% of existing tenants receive benefits and pay their rent through an order on that benefit. If there is no means of transferring these arrangements, all these tenants will have to make new ones. Housing New Zealand will collect this money and pay it to Trust House Limited in the short term, until Trust House Limited can reach an agreement with Work and Income New Zealand.
- Trust House Limited intend managing the portfolio from their current office. This office is unsuitable as a location from which to administer the tenancies. It is directly above a large wholesale liquor outlet and is up two flights of stairs that lead directly into the Trust House Limited executive office. In the interim Housing New Zealand will provide its' current premises, while Trust House Limited establish their needs in this regard.

In the longer term, issues will include:

- Tenants currently have the right to buy their properties. It is Trust House Limited's intention to implement a tenant purchase programme.
- Trust House Limited's administration of arrears and maintenance.
- Trust House Limited's rent setting procedure.

Trust House Limited is committed to serving the same target market as Housing New Zealand and has agreed to give priority to those in the greatest need. Trust House Limited also acknowledge the obligations and social responsibility in Housing New Zealand's current Statement of Corporate Intent.

The customer impacts will be dealt with in three phases:

1. A Due Diligence Phase of one month

This phase will occur between the signing of the Sale and Purchase Agreement and the unconditional date (18 December 1998 – 1 February 1999).

In this period, Housing New Zealand will introduce Trust House Limited to the business and the administrative systems required to run it. The practical problems of transfer referred to above will be dealt with in this phase so that the tenants notice no negative change as a result of the sale.

2. A Working Relationship Phase

This will begin on the 1 March 1999, being the settlement date, and run for a period yet to be determined.

It is proposed that Housing New Zealand pay for one local staff member to assist the purchaser with administrative matters and knowledge of the client base during this phase.

Housing New Zealand also intends to allow the purchaser to run the rental business out of the existing and easily accessible Neighbourhood Unit, which is located in the main street of Masterton. Tenants will notice no negative change following the sale.

3. Access Facilitation

In addition to working alongside Trust House Limited, Housing New Zealand will spend the "working partnership" period developing an access facilitation position in the Masterton Community. This person will be responsible for ensuring that the market is meeting urgent housing needs in the area. This role will develop over time, as it is tested in pilots around the country.

11. Timetable

<i>17 December 1998</i>	Board Approval of Sale & Purchase Agreement
<i>18 December 1998</i>	Local announcement made – communication to those affected and interested in the initiative
<i>18 December 1998- 1 February 1999</i>	Due Diligence
<i>1 February 1999</i>	Unconditional Date
<i>2 February 1999- ongoing</i>	As required – bridging management period
<i>1 March 1999</i>	<i>Settlement Date</i>
<i>To be decided</i>	Access Facilitation Role

12. Conclusion and Recommendation

The initiative to sell 576 properties currently managed by the Masterton Neighbourhood Unit to Trust House Limited is an integral part of Housing New Zealand's reconfiguration strategy. This sale is supported by financial analysis (FAM) and an independent valuation from Darroch Limited.

It is recommended that the Board:

- **Approve** the sale of all 576 properties in the Masterton Neighbourhood Unit to Trust House Limited and authorise the Chief Executive Officer to sign the attached agreement for Sale and Purchase.

Nigel Spratt
Manager – Private Finance Initiatives

Supported

Brian Roche
Chief Executive

Brian Donnelly
Manager Asset Reconfiguration