1. Executive summary

Background

- Cabinet agreed on 11 April 2011 to the further development of Option4 for the managed divestment of Hobsonville point project. Andrew Body Limited was retained by HNZC to assist it and HLC in preparing the detailed strategy for Option 4, for submission to the Joint Ministers by 30 June 2011.
- Our brief recognised some key constraints in the development of Option 4 including the desire to achieve complete divestment within five years, the need to manage public works and right of first refusal risks and the need to be able to successfully implement the plan.
- While Option 4 had been already developed to some extent on closer examination it was apparent that Option 4 did not realistically allow for:
  - A wide range of difficult property, finance and general economic conditions that may continue to prevail for the foreseeable future
  - The current unproven state of the project
  - The imbedded optionality that exists in the project.
- As a consequence, in conjunction with HLC management, we have developed a revised Option 4 called Option 4R.

Option 4R and other options' financial analysis

- Option 4R envisages:
  - Proving or modifying the Hobsonville Point product to accelerate retail revenues and reinforce expectations of success for the project
  - Switching to wholesaling larger parcels of land when the product and "place" has been proved, allowing the private sector to determine outcomes for the project from that point
  - Deferring civil works
  - Removing unnecessary costs from the project as possible
  - Not purchasing further NZDF land if such purchases are uneconomic
  - Not continuing with the s9(2)(ba)(ii) arrangement if it is not beneficial to the Crown.

- Detailed financial modeling of Option 4R was undertaken which showed:
    - A base case valuation of $78m at 1 July 2011 on a reasonable set of assumptions assuming Option 4R is successfully implemented.
    - the value is very sensitive to the key value drivers of absorption rate, land value growth and wholesalers' required rate of return with Option 4R having a reasonable value range of $25m to $142m at 1 July 2011
    - The financial model is not clearly determinative of the net benefit of [redacted] continued involvement in the project and instead there were some key judgements that were required
    - The current purchase price of the remaining NZDF land was probably about $11m too high
    - Existing funding arrangements with the Crown should be adequate.
- The original options 1B and 4 (4O) were also modeled with the results suggesting the original NPV's of these options relied on unrealistically optimistic assumptions. Using Option 4R assumptions generated values of $90m for 1B and $71m for 4O at 1 July 2011.
- An early divestment by 1 July 2012, using realistic assumptions for the key value drivers, suggests a value of $40m.

Financial and delivery risks of Option 4R

- Increasing the absorption rate and land value growth for the project will reduce the Crown's financial and delivery risks. In particular achieving this increase earlier will substantially positively impact value of the project.
- HLC and [redacted] current expectation of absorption is 6 lots per month and 10 lots per month respectively for the years to June 2012 and June 2013. Option 4R assumes 5 lots per month for the first three years stepping up to 15 lots per month after that.
- Our analysis and market soundings suggest that there is material risk to the Crown that the end product offering of houses at Hobsonville is not properly positioned or priced to meet the expectations of the target markets.
- Consequently there is a material risk that HLC and [redacted] short term expectations of absorption will not be fulfilled and that Option 4R's assumption of 15 lots per month in the long term will not be met.
- In the event that these risks are crystallised the Crown's financial and delivery expectations will not be achieved by a substantial margin. We expect the NPV outcome to be well below $50m in this event.

Reducing financial and delivery risks of Option 4R

- In order to increase the absorption rate and land value growth HLC needs to re-evaluate the product positioning and pricing to rapidly facilitate the house developers meeting the market in terms of both product specification and price point.
- Product positioning needs to be correct at all levels, including lot layout and size, architectural style, house configuration and specification and landscaping. Ensuring the product is affordable for "first movers" in the target markets will also be crucial. A highly integrated planning approach between HLC and the house developers is required.
- Rapid experimentation with product positioning, enabling house developers to improve the security they offer for debt finance, offering limited numbers of risk sharing arrangements for the construction of houses and reducing costs as possible on the project is required.

- Further streamlining and clarification of governance is also required to improve flexibility and the ability to select and achieve objectives.
- A crucial part of the management of the project, the development of the first precinct (Buckley A), has been contracted out to [redacted] While the financial analysis does not clearly determine their net benefit to the Crown the success or failure of the [redacted] arrangement will heavily influence the success or failure of the detailed strategy for Option 4R.
- We suggest that a review occurs of the [redacted] arrangement for Buckley A, in the context of the plan and objectives that the Crown adopts. Particular it should compare the [redacted] arrangement to other possible arrangements in the context of alignment with the Crown's objectives and [redacted] ntegration into the planning to achieve those objectives.
- The work we have undertaken is able to be used to create a new set of key performance indicators and a new budget for the project to facilitate monitoring.