The Treasury

Budget 2013 Information Release

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In preparing this Information Release, the Treasury has considered the public interest considerations in section 9(1) of the Official Information Act.

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THE TREASURY
Kaitohutohu Kaupapa Rawa

Date: 11 March 2013

To:
Minister of Finance
(Hon Bill English)

Deadline: Wednesday 13 March, 8:30pm

Aide Memoire: Income-Related Rent Subsidy (IRRS) extension: Budget 13 provisions

You are meeting with Hon Dr Smith on the evening of Wednesday 13 March to discuss the housing affordability and social housing package Cabinet papers, which will inform Budget decisions.

One issue around the social housing package which needs to be resolved urgently is what provision Ministers wish to make for the IRRS extension in Budget 13. The current draft of the social housing Cabinet paper outlines three broad options for extending the IRRS scheme, but does not seek agreement at this stage to one approach, or to any funding. As we understand it, MBIE's preference at this stage is to seek a contingency at Budget 13 for extending IRRS to the non-government sector, so that further necessary policy work can be done.

A case can be made for a contingency, given that there is a suite of policy and operational decisions that need to be taken before funding can flow. It is also unlikely that much, if any, extended IRRS funding will be allocated in 2013/14, given the need to set up associated regulatory and contracting systems. However, if Ministers want to announce the IRRS extension at Budget, you will need money appropriated in the Estimates. Contingencies are not published in the Budget documents. **We recommend that Ministers decide at your meeting on 13 March whether or not you want an announceable for Budget 13 on the IRRS extension (and hence an appropriation in the Estimates).**

Regardless of whether Ministers want an appropriation or a contingency, some decisions need to be taken about the amount of money to be allocated to the IRRS extension through Budget 13, and timing. For the purposes of taking these decisions, we recommend that Ministers:

- **Support 'Option B' outlined in the draft Cabinet paper – i.e. agree to a limited growth path for the non-government sector, in addition to the current forecast IRRS expenses in HNZC**. Applying a 'sinking cap' on HNZC places (Option A) will generate few funds for the third sector in the short-term and will have little impact on its development, and opening up IRRS to all or most existing providers (Option C) would be unduly expensive and wasteful. Over the long-term, however, you should look to set a global cap for the system.

- **Assume that eligibility for the new IRRS funding will be limited in the short-run to:**
  - **Non-government providers** (i.e. not local government providers).
  - **Providers who can meet regulatory requirements**. In the short-term, the best proxy for this is the Social Housing Unit's 'pre-qualification' process, although this may be replaced or augmented through the Social Housing Reform Programme. In Treasury's view, both for-profit and non-profit providers should be eligible to participate.
  - **New applicants for IRRS (as assessed through SAS), or existing A/Bs.** Existing tenants of third sector providers will not be able to qualify for IRRS under current SAS settings, as they are already housed. This will create some short-term inequities, as new tenants in the non-government sector qualify for IRRS, but existing tenants who may be in similar circumstances do not.
  - **IRRS portability:** In order to introduce some competitive tension in the system, we also recommend that existing A and B tenants in HNZC properties be able to transfer into the third sector, while retaining their IRRS. As is currently the case for tenants who wish to transfer *within* HNZC, this would trigger a test of their continuing eligibility for IRRS.
- **Agree to a maximum per-annum amount of funding for the extended IRRS, rather than to a set number of places or houses you will fund**. This would help manage fiscal risk, as there is currently little information on market rent rates in the third sector. These may be higher than for HNZC houses, especially if the third sector assets are newer or in better condition.

How much Ministers wish to allocate for the third sector depends on what sort of response you expect from non-government providers. There are currently 1,350 tenancies within SHU's pre-qualified providers. We understand that some of these providers have ambitions to grow, although new acquisitions are not expected to be in place for at least 2-3 years.

For the purposes of making Budget decisions, a contingency or appropriation of $10-20m over four years seems reasonable. HNZC's current turnover rates are 8% per annum. If a similar churn rate was assumed for the third sector, this would see around 100 new households being funded through the extended IRRS a year, at a total cost of around $11-12m over four years. A higher appropriation (e.g. closer to $20m over four years) would better allow for new entrants or other unanticipated supply responses, but there may still be a need for rationing if the sector is very responsive.

MBIE's preference is for a larger contingency of $61m over four years. This would provide greater scope for growth within the sector and would enable existing third sector tenants to apply for IRRS funding without going through the full SAS assessment. MBIE considers that this would move policy settings much closer to a level playing field. Treasury believes that the priority at this point is that eligibility for IRRS remains carefully managed and that this option would increase deadweight cost. If you are concerned about consistency of treatment, the better option would be to not make IRRS portable for HNZC tenants.

There will be some reductions in Accommodation Supplement under either option, which will help offset some of the costs. These are still being worked through, but may not be sufficiently firm to be booked as savings for Budget 13.

Either a $10-20m or a $61m allocation is best considered a first step towards your social housing end state. It is not a sustainable long-term solution for funding social housing. It does not increase supply, and does not support a fully level playing field between HNZC and non-government providers. It does introduce some competition with HNZC through IRRS portability, but this will be very much at the margins. In addition, the $10-20m funding would only allow growth in third sector IRRS places in the first three years of the scheme. Per annum funding would flatline from 2017/18 onwards (although this depends on how quickly the extended IRRS is implemented, and how quickly the third sector responds). Pressure for further assistance from the third sector is likely to rise at this point.

The Government will need to review funding levels for the third sector relatively soon, ideally as part of a wider review of housing financial assistance, which would include setting a cap for the entire scheme, allowing resources to move more smoothly between providers, moving to a model based on clear prices, and addressing the other problems with IRRS as an instrument. [6]

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