2. HORNBY HOUSING PROJECT – REPORT OF THE HOUSING WORKING PARTY

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The purpose of this report is to progress two issues in respect of the Hornby Housing Project by way of seeking Council resolution on a strategy for:

- Sale of some first stage units.
- Development of the balance of the site.

These issues were considered by the Housing Working Party on 19 October 2000 and their recommendations appear at the end of this report.

1. BACKGROUND

The Hornby Housing Project envisages the development of mixed housing on a 1.8 hectare block of Council land bounded by Main South Road / Goulding Avenue and Shands Road in Hornby. Since May 1999 a partnership between James Lunday of Common Ground and City Design in consultation with the Housing Working Party have been responsible for project design, tender and supervision. The design was approved by the Housing Working Party and Community Services Committee through a number of design workshops and meetings. Tender for construction was won by Fletcher Construction and accepted by resolution of the Council on 12 May 2000.

This construction contract relates to what is called Stage 1 of the total development site as indicated on the tabled plan (appendix A). Stage 1 comprises 22 elderly people's housing units: nine single-bedroom units (four ground floor and five first floor units), and 13 two-bedroom units (ten on the ground floor and three on the first floor). Five of the first floor units are lift accessible. Plans are tabled (appendix B).

Since the project was first mooted the Council has approved in principle the sale of some units. The following serves to outline how this might be achieved.

2. SALE OF UNITS

There are two fundamental issues to be resolved when considering the sale of some units.

1. Legal title structure.
2. Nature of equity participation.

2.1 Legal Title Structure

Five title options have been considered; Flat Owning Company, Composite Titles, Fee Simple Subdivision and Lease or Licence to Occupy. These first four have been discounted from suitability as they contain some disadvantages whilst a fifth option of creating Unit Titles has some clear advantages.

The benefits of a unit title ownership scheme are:

- A clear survey definition of public and private areas.
- Service easements implied by statute without the need for survey.
- A relatively flexible and transparent basis for cost sharing of insurance, maintenance and other expenses.
- A formal mechanism (through the body corporate) for a community based approach to management of the complex and its common facilities.
- Individual units (including land) defined by survey, which can be leased on a long term (currently 20 years or more) basis without constituting a subdivision.
- Provides a greater degree of control and flexibility.

The potential disadvantages of the unit title option are:

- Perhaps the requirement to pay reserve fund contribution.
- If the Council sells units carrying more than 50% in value of total unit entitlement, the Council could lose effective day-to-day control.

In summary, the Unit Title option is preferred. Proprietors of units that are sold have a more obvious ownership interest, i.e. a more clearly defined role as stakeholder through an ability to exercise voting rights in respect of their units at meetings of the body corporate. In addition it offers the greatest flexibility to allow the Council to achieve a truly partnered approach to this community housing project.

2.2 Nature of Equity Participation

Creating owner/occupier status in entirety where the occupier has all the equity or ability to borrow and purchase in full exists in 28 of the Council's existing portfolio of 2,600 units. The current mechanism to facilitate this is relatively simple. The purchaser enters into a simple agreement that confers an obligation on the owner in respect of maintenance and provides the Council with an option to purchase on sale. Any capital gains are divided 50/50 and in the past the Council has exercised its option for the purposes of maintaining control over whom the future owner/occupier is.

However, in endeavouring to create proportional ownership, complications can arise in respect of security, control, responsibilities, obligations and conflicts of interest. Bearing this in mind a number of mechanisms have been considered to establish equity. These are: Rent to Buy, Proportional Ownership, Ground Lease and Financial Purchase.

These first four have been eliminated from contention as they have a number of disadvantages and inherent difficulties. However, a fifth option for which we have coined the term "Tenant Investment" warrants favourable consideration. Rather than having co-ownership this involves tenants advancing money to Council on a basis whereby, say:

- An advance is expressed as a percentage of the market value of the unit at the date of the advance.
- The rental is discounted by the amount of that advance.
- On the death of the tenant, or the tenant vacating or being ejected, the market value is recalculated and any gain or loss shared pro rata.

A structure that involves the advancing of monies to be repaid in these circumstances is in the nature of a debt security under the Securities Act 1978. Where there is sharing of equity gains and losses there is an arrangement in the nature of a participatory security under the Act. In either case there would be a need for a Trustee, a Trust document and perhaps also a prospectus, although an exemption may be available from the prospectus requirements. This will obviously add expense, which could be approximately $25,000 for initial establishment costs, and $10,000 per annum thereafter. However, this expense may be justified by the level of demand. One issue which will need resolution is to decide what happens to the interest earned on contributions paid. This, however, is detail requiring further investigation and consideration.

The benefit of this structure is that there is equity participation falling short of actual proportionate ownership. Therefore there is a clear relationship of landlord and tenant on one hand and lender and borrower on the other. The disadvantages are the lack of "ownership" and potential structure costs. While there are also matters of detail to work through in relation to compliance with the Securities Act, they do not appear, after cursory consideration, to be insurmountable. It may also be possible to have the same scheme encompass units in a number of different complexes and therefore this form of participation scheme could be implemented across the Council housing portfolio at any stage in the future.

2.3 Summary and conclusion

The units could be sold in entirety, i.e. 100% owner/occupier status, without any difficulty under similar arrangements that already exist to a limited degree in the Council's current housing portfolio.

Proportional ownership is, however, more difficult and complex. The last mechanism, Tenant Participation, would appear to be the most practical and workable. There will, however, be reasonable set-up and structure costs even with a proportional ownership scheme and it is therefore prudent that such initiatives only be considered where there is some "economies of scale". In this current project thought is being given to creating some form of equity participation for 20% of the units (i.e. four to five) and therefore the creation of such schemes will probably not be cost effective.

Any mechanism that creates proportional ownership is likely to be somewhat complex and add additional cost.

Interest has been expressed from a number of people to be involved in some form of equity participation scheme. Applications for this project to date can be categorised as follows:

Owner Occupier	16 Applications
Current Rental tenants wishing to transfer	12 Applications
New Rental applications	21 Applications
Total Rental	33 Rental Applications

Should Council remain desirous of embracing the concept of proportional ownership the prudent way forward would be to market both a development and concept pre project commitment so that demand and feasibility can be accurately evaluated. Alternatively if there is sufficient demand it appears possible to create the scheme coined "Tenant Participation" over a number of complexes, including existing, so long as tenure can be created through unit title.

We should bear in mind that equity participation may be less attractive now and in the short to medium term future as the market shows all signs of decline and it is becoming more widely acknowledged and accepted that capital loss is a real prospect.

3.0 FUTURE STAGE DEVELOPMENT OPTIONS

It is firstly important to note that creation of legal title through a strata development under the Unit Titles Act as recommended earlier is ideal in respect of creating staged developments and provides a high degree of flexibility to cater for the varying nature of future stages.

Speculative development would be risky and imprudent. Additionally the future development of the site is too big to be considered as a project that could be completed out of the Housing Development Fund without its significant depletion. It is therefore probably necessary to either complete the project with partners or some form of borrowings.

It would also appear that stages 4 and 5 lend themselves towards a more commercial focus and are therefore less likely to assist in achieving the Council's housing objectives. This seems particularly so with stage 5 terraced apartments / warehouse / business units. Stage 4 also appears to be in direct competition with Housing New Zealand, and therefore they should be canvassed as a potential joint venture partner. In any event the family sector of the market is well catered for as it widely recognised that Housing New Zealand and the private sector have significant stock of this type. That is also expected to experience falling rents in the short to medium term with an evident increasing over supply.

In view of these issues we tend towards preferring a joint venture/partnership arrangement for future development of this site. There is, however, a number of other options that could be considered:

1. Development and sale of the land only. This can be undertaken on a unit title basis as described earlier in this report. The advantage is that minimal capital is required in comparison to a full improvement development. The disadvantage is that it would provide only limited control over future design and concepts.
2. The election of developing only one or two future stages with the balance sold off on the open market. This, however, would give rise to a lack of control and the values to be realised from selling portions of the undeveloped block are not likely to be significant.
3. Borrow the funds to complete the entire development as conceptualised. This, however, is likely to be significant and represent a disproportionate and risky investment in comparison to the balance of the housing portfolio fund.

Having said this, achieving the second option above would not be precluded from an option that seeks development partners.

We caution that any joint venture options are complicated by the potential that any such venture "organisation" might be classed a LATE under section 594B of the Local Government Act. Clearly any structure adopted must avoid that possibility. Accordingly Council may be restricted to the use of traditional techniques, to avoid the risk that innovation inadvertently gives rise to LATE related concerns, as did eventuate in the earlier structures considered for the Beckenham Housing Project. The options would appear to be:

1. Borrowing to fund the balance of development, and selling as many units as was necessary on completion of the development to enable repayment of the borrowing. This obviously contains an element of risk. Design and budget would need to be carefully managed so that the potential "cost to value" issues arising from Stage 1 are not repeated.

2. The Council could lease the land to a private sector developer for the construction of units by the developer and the sale of those units. The developer would be able to recoup construction costs and a developer's margin from the sale of the units. The Council would agree to buy back those units that it wishes to have for rental housing purposes. It could also, in its arrangement with the developer, preserve pre-emptive rights of purchase. This would, however, result in a measure of complexity with more than one body corporate on the site, with some in freehold and some in leasehold. It may also result in uneconomic rental rates due to the requirement to pay market ground lease rentals.

3. The sort of joint proposal that appeals at this time is a joint venture whereby Council contributes the land and the developer contributes the construction costs. On completion of the development, units equivalent to the value of land will remain in Council ownership, with the rest of the units being transferred to the developer in satisfaction of the construction costs. The developer would recoup its investment from the sale of units, on terms that may require purchasers to grant to the Council the right to buy back under the traditional agreement. The advantage of this proposal is that construction cost is funded by the developer, who bears (almost entirely) the market risk. The incentive from the developer to control costs would be high, but so too "perhaps" the incentive to economise on quality to increase returns. Because market risk is transferred, however, a developer is unlikely to want to be subject to too much (if any) control by Council on sale pricing.

In considering the seeking of partners the issues to be resolved are really those of timing and process, and the Council could either:

(a) Market the James Lunday concept for sale and / or lease seeking a level of pre-commitment, following which a feasibility study could be undertaken with a reasonable degree of certainty. Should the project prove viable partners could be sourced and financing issues resolved.
(b) Seek partners with whom the following stages of concept planning, marketing, feasibility and finance could be jointly developed and shared.

Both approaches allow the assessment of market demand and viability before committing project capital. The latter approach provides for the pooling of ideas and resources, along with the development of finance concepts at an earlier stage. It would also provide for earlier separation of what might be considered the more commercial components of the future stages.

The following are considered to be advantages to the latter approach but disadvantages to the first:

- Flexibility versus early commitment to design.
- A greater rather than limited input from partners.
- The potential for preliminary development costs to be shared e.g. marketing and feasibility.

The answer as to which approach to adopt hinges greatly on how committed to the existing concept plan the Council is and whether we believe it is viable. There have been no feasibility or demand studies and our perception of advantages and disadvantages favours seeking joint venture partners earlier rather than later.

We believe the only way to progress this matter to avoid the pitfalls of dealing unilaterally or in an ad hoc manner is to call for request for proposals (RFP's) for joint venture / partner developers loosely based on the James Lunday concept development plan. This should be done along the lines of encouraging the latter development but should not stifle innovative proposals.

We indicate below a proposed outline of specific issues to be incorporated into the Council's standard RFP document:

Objective

To seek joint venture / partner developers for the balance of the Hornby Housing project site.

Ideology

- Development to be primarily based on the James Lunday concept.
- To promote a high quality development both in terms of design, sustainability, open space living and interconnectivity with the overall development site, including the Council's existing stage 1.
- A preference to create a partnership loosely structured as outlined in (3) above.
- Ensures the Council's housing policies and objectives are achieved and maximised.
- The process and arrangements minimises risk.

The Council's Contribution

The Council envisages that it can contribute the following to any partnership / joint venture:

- Land
- Capital
- Design, planning, project management and professional support
- Tenants and / or purchasers under some circumstances
- Professional and experienced facilitation

Flexibility

The proposal should indicate that the Council is flexible to consider a number of proposals and initiatives including the development and sale of some portions for a variety of financing and sharing arrangements.

A marketing campaign for proposals should incorporate a direct mail out to all Christchurch builders, construction companies and property developers; normal newspaper advertising; and solicitation of real estate agents.

Recommendation:

1. That units are developed on a basis which facilitates unit titles being created in the future.

2. That the Council market between 20% and 30% of units for sale at cost.

3. That the principle of proportional ownership be adopted with the necessary one-off Trust and other associated costs being funded from the Housing Development Fund.

4. That the disposal of units through the proportional ownership scheme be included in the 20% to 30% noted above in clause 2.

5. That the Property Manager bring to the Community Services Committee guidelines of eligibility for outright/proportional ownership.

6. That an RFP (Request for Proposal) document and marketing programme, which seeks joint venture/partner proposals for the future stages of development as generally described, be developed for consideration and approval by the Community Services Committee.