

# The Treasury

## Budget 2024 Information Release

### September 2024

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Date: 24 January 2024

To: Minister of Finance (Hon Nicola Willis)

Deadline: None  
(if any)

## **Fiscal Consideration of Amortisation in Vote Housing and Urban Development**

This advice responds to your request for further information on amortisation funding requirements in Vote Housing and Urban Development. This builds on our previous advice on the fiscal risks associated with amortisation issues with <sup>[33]</sup>

The Minister of Housing has three briefings that Treasury has advised need all amortisation funding requirements to be resolved before they can be progressed. The Ministry of Housing and Urban Development (MHUD) is providing advice to the Minister of Housing and how to progress these papers and address the amortisation shortfall. We understand that the Minister of Housing will seek agreement from you on next steps.

This paper:

1. provides an overview of the amortisation expense requirements in the Housing Portfolio and how we've arrived in this position;
2. advises you why agreeing to the Minister of Housing's proposals at this time risks limiting the Coalition government's ability to achieve your broader fiscal objectives; and
3. recommends that these requirements are considered through the Budget 2024 technical process meaning that the Minister of Housing's proposals will be delayed.

### **Some grant payments in Vote Housing and Urban Development trigger amortisation requirements**

Several programmes administered in the Housing Portfolio are delivered by providing grant payments to housing providers and other entities. Grant payments have been made for several reasons, including to pay for infrastructure development, delivery of affordable housing, and increasing the capability of housing providers.

Ordinarily, grant payments are treated as an operating expense, as a service or good is purchased in exchange for cash. In most circumstances, when the Crown makes a grant payment, an operating expense is recognised and incurred against an operating appropriation. An impact on both net-debt and OBEGAL would be recognised at the time the payment is made, equal to the value of the grant payment. For example, if a \$50 million grant was awarded to a community housing provider in FY23/24, then net-debt would increase by \$50 million in FY23/24, with a corresponding impact on OBEGAL.

### **Some grant payments made in Vote Housing and Urban Development will be expensed over a number of years**

This includes payments made in the Affordable Rental Pathway, the Māori Housing programme and some payments made to public, community and transitional housing providers. This is due to the grant payment being tied to a long-term performance obligation on the grant recipient. For example, if a grant payment was awarded for the delivery of affordable housing the relevant performance obligation would be linked to the successful delivery of affordable housing. These grant payments are referred to as upfront payments, as cash is paid out prior to the exchange of any goods or services.

Upfront payments are initially recognised as an asset on the Crown balance sheet, which fully unwinds over time (the non-cash amortisation expense) as performance obligations are achieved. Upfront payments will impact net debt immediately, however, the impact on OBEGAL will depend on the phasing of the subsequent amortisation expense. As the amortisation expense is non-cash, there is no further impact to net debt.

A capital appropriation is required to authorise the upfront payment while an operating appropriation is required to authorise the amortisation expense. The relevant appropriations in Vote Housing and Urban Development are the Upfront Payments MCA and the Amortisation of Upfront Payments MCA.

The point at which the amortisation expense is recognised depends on the nature of the performance obligation in the grant funding agreement. In some circumstances, it is most appropriate to amortise the performance obligation when the project has been fully implemented. For these contracts, an amortisation expense occurs only once, at project completion, for the full value of the grant contract. In some contracts with multiple milestones, amortisation is recognised and expensed in stages as each milestone is reached. The timing and nature of amortisation expenses is driven by accounting practices and the specific grant funding agreement. From conversations with MHUD we understand that the contracts they have entered mostly involve straight-line amortisation in milestones.

**There are discrepancies between the financial year that the upfront capital grant payment is provided, and the year(s) the operating amortisation expense is recognised**

As there is potential for volatility with the delivery of projects, it is challenging to forecast the timing of the amortisation expense with certainty. This means that the expense may occur in different financial years than initially anticipated changing the financial year in which the OBEGAL impact is recognised.

A table summarising the differences between the OBEGAL and net-debt impacts of ordinary grant funding and grant funding with an associated performance obligation is included in **Annex One**.

**There is insufficient authority to cover amortisation expenses in the Housing Portfolio**

There is currently insufficient authority in Vote Housing and Urban Development to cover all required amortisation expenses. From an appropriation perspective, the total appropriated funding for the purpose of making upfront grant payments (i.e., the capital/asset component) is substantially higher than the total appropriated funding for the purposes of amortising those upfront payments (i.e. the write off component).<sup>1</sup> If the amortisation related appropriation is not increased, then MHUD will incur expenses without Parliamentary authority.

**This shortfall is a result of several events as outlined below**

MHUD has been engaging with KPMG in an iterative process to improve understanding of, and, ensure compliance with, accounting requirements. Throughout this time, MHUD did not seek to appropriate sufficient amortisation funding and, at times, stated that it would request additional funding and then did not do so. Throughout this process, the Treasury did not identify the amortisation funding shortfall at the time policy proposals were agreed and did not identify that MHUD did not seek additional funding. The key events are:

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<sup>1</sup> This is taking a long-term view extended beyond the forecast period.

March Baseline Update 2023: HUD2023-001516. In March 2023, adjustments were made to appropriations in Vote Housing and Urban Development as part of MBU. The MBU letter made several references to the need for further funding to be subsequently appropriated for amortisation purposes to reflect accounting requirements. These references were:

- \$127.022 million to amortise prepayments for Māori Housing providers;
- \$69.169 million to amortise prepayments for Māori Infrastructure Projects; and
- [33]

Budget 2023. As part of Budget 2023, additional funding of \$382.324 million across the forecast period was appropriated into the Upfront Payments MCA in Vote Housing and Urban Development:

- \$150 million for *Māori Housing Supply, Capability Building and Repairs* (outyears funding of \$37.5m was also appropriated);
- \$70 million for 2023/24 for *Temporary Accommodation response to the Auckland flooding and Cyclone Gabrielle*;
- \$62.324 million from 2023/24 to 2024/25 for *Actions to Improve Alternatives to Emergency Housing Special Needs Grant Accommodation*; and
- Pathway \$100 million from 2023/24 to 2024/25 for *Technical Initiative Affordable Housing Fund – Affordable Rental Pathway*.

A total of \$45.916 million was also appropriated into the Amortisation of Upfront Payments MCA in various categories within the forecast period. Outyears funding totalling \$10.075m per financial year was also appropriated into the MCA.

### **The Treasury was explicitly informed of outstanding amortisation issues in August 2023 and took steps to address the discrepancy**

In August 2023, MHUD notified the Treasury that MHUD was intending to seek a technical increase to the Amortisation of Upfront Payments MCA to cover amortisation expenses. There was extensive correspondence between the Treasury and MHUD's finance team with the aim of rectifying the issue of insufficient authority to incur amortisation expenditure. Key developments from this process are:

- MHUD noted that the primary reason they had not previously sought agreement from Ministers to appropriation increases to the amortisation of Upfront Payments MCA was because they were working with KPMG to determine appropriate accounting treatments across the Housing Portfolio.
- The Treasury noted that given current understanding of accounting treatment, MHUD should seek Joint-Minister approval to increase the Amortisation of Upfront Payments appropriation as part of the 2023 October Baseline Update (OBU) process.

- Given the significance of funding required, and the impact upon OBEGAL of seeking this non-cash funding, the Treasury also recommended that MHUD produce a briefing prior to the OBU submission to inform Ministers of the anticipated request.
- MHUD's finance team progressed the development of a briefing outlining the need for additional amortisation funding in late September. The Treasury provided feedback on this draft document, however, the briefing was never finalised and provided to Ministers.
- MHUD did not seek an increase to the Amortisation of Upfront Payments appropriation as part of the OBU process noting that they were still seeking advice from KPMG to ensure they were accounting for payments correctly.
- Given these decisions, the Treasury advised that MHUD would need to make a submission in the Specific Fiscal Risk exercise as part of HYEPU, covering the likelihood and quantum of operating funding needed for amortisation purposes.
- MHUD made the submission as requested noting there was a 20-50% chance of \$445.137 million of additional operating funding being required over the forecast period. From conversations with MHUD, the Treasury understood that there was still uncertainty around the quantum of funding required in the forecast period and MHUD were still working to evaluate contracts to ensure compliance with accounting standards.
- Given the incompleteness of information, as part of HYEPU 2023, the Treasury published a new specific fiscal risk in the Housing Portfolio *Amortisation of Upfront Payments (Cost Pressure or Variance – Expenses)*. This risk noted that there may be insufficient operating funding within the forecast period.

**We recommend considering the amortisation shortfall as part of the technical Budget process**

Treasury recommends that all amortisation requirements in the Housing Portfolio should be addressed prior to any further policy decisions being taken, rather than dealing with each issue as it arises. This will allow you, and your Cabinet colleagues, to have a full understanding of the current state of the shortfall and the fiscal implications, as well as ensure all future decisions can be considered with respect to value for money and broader fiscal goals.

We note that MHUD has several other potential non-cash issues (not specifically related to amortisation) that will require further funding to be appropriated e.g. concessions on loan agreements that require additional non-cash funding to cover the concessionary element.

MHUD is best placed to provide advice on the specific decisions required to address the full fiscal implications of the amortisation shortfall. This is because the Treasury only has visibility of appropriation level data and does not have access to micro-level contract data necessary to advise on which expenditure is affected.

MHUD is preparing a briefing on options for you and the Minister of Housing which we understand will present the following options:

1. **Seek the full amount of amortisation funding in two stages.** Under this option, we understand that MHUD would seek amortisation funding for projects already contracted as well as projects currently under consideration <sup>[33]</sup> (Affordable Rental Proposal). This would occur in advance of MBU to enable these to be progressed without further delay. The outstanding amortisation funding required for future projects would then be considered at Budget technical. Increasing the amortisation non-cash appropriation will have a corresponding impact on OBEGAL unless this is managed against allowances.
2. **Appropriate amortisation funding for those projects already contracted.** This would deal with the technical issue as it currently stands to ensure there is sufficient authority for things that have already been committed. Any remaining uncontracted capital funding could then be returned to the centre and the relevant programmes cancelled (with a corresponding improvement to net debt). This would be done through budget technical.
3. **Fiscally neutral adjustments (e.g. reprioritisation) across appropriations to address the funding requirements.** This would mitigate the overall fiscal impact, noting that this may involve cancelling contracts and would take time to implement. It is difficult to know whether this option is credible without further information on the magnitude of changes required.

Given the quantum of the amortisation issue and the challenges it could present to your fiscal goals, our advice is that any appropriation changes (including any other non-cash issues) are best considered as part of the technical Budget process.

Considering these issues through the technical Budget process allows for choices to be made around managing the fiscal impacts, for example, by reducing allowances to account for non-discretionary choices without affecting the OBEGAL position. This would constrain the level of funding available for other policy priorities as part of Budget 2024. This approach most closely aligns with option 1, with additional work required on other non-cash issues. However, proposals currently in train would not be considered for several months (i.e., they would be further delayed).

If you instead choose to proceed under MHUD's option one above, this would reduce your options for managing the fiscal impact as part of the technical Budget process, but would enable those projects that are currently awaiting amortisation funding to progress.



## **Implications for the Affordable Housing Fund Paper: Affordable Rental Pathway Round One and Round Two Funding Recommendations (HUD2023-003094)**

You have received a paper from MHUD signed by the Minister of Housing, titled *Affordable Rental Pathway Round One and Round Two Funding Recommendations*. The paper seeks your approval to progress 14 further proposals in the Affordable Rental Pathway. This would require \$58.263 million be expensed from the Affordable Housing Fund category of the Upfront Payments MCA. As above, all proposals in this paper necessitate that an amortisation expense be recognised at a future point.

We recommend you do not agree to these proposals unless the amortisation issue has been dealt with as described above. The amortisation expenses associated with the 14 proposals are not addressed as part of this paper. No authority is sought in the paper for an increase to the Amortisation of Upfront Payments MCA required to give authority for additional amortisation expenses to be incurred. Agreeing to the proposal as it currently stands will increase future expenses incurred without Parliamentary authority.

Assuming that the amortisation issue has been dealt with, the Affordable Rental Pathway brings forward the development of affordable housing at a lower cost than public housing and can reduce the reliance on other government subsidies like accommodation supplement. We also are aware that the Minister of Housing has raised questions with MHUD on the value of the pathway. MHUD officials should provide advice on how the Affordable Rental Pathway and broader package of funds and programmes can best achieve your housing objectives.

Treasury has not had sufficient capacity to review the specific proposals in the Affordable Rental Pathway to determine whether they represent value for money. They appear to broadly align with transactions previously approved by previous Ministers within the pathway. When considering these transactions you should balance the costs, against the number of homes delivered, affordability benefits, and housing need in the relevant location. For example, *Queenstown Lakes Community Housing Trust* is seeking a grant of ~\$500,000 per home, which is much higher than the other proposals. You should ask the Minister of Housing whether he is confident that the benefits of delivering in Queenstown outweigh the additional costs.

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## Annex One:

Type of grant	Appropriation type required	Impact on net debt	Impact on OBEGAL	Total funding to be appropriated
		Timing	Timing	
<b>Without performance obligation</b> <i>(e.g., standard grant)</i>	1. Operating expense	1. Equal to the value of the grant payment	1. Equal to the value of the grant payment	Equal to the value of the grant payment
		When grant payment is made	When grant payment is made	
<b>With performance obligation</b> <i>(e.g., up-front payment)</i>	1. Capital expenditure <i>(performance obligation itself)</i>	1. Equal to the value of the grant payment	1. No additional impact - it's an asset	Double the value of the grant payment
	2. Operating expense <i>(write-off/amortisation)</i>	When grant payment is made	2. Equal to the value of the grant payment  Varies by Contract	