

# Exploring Governance and Accountability Issues in Government Funding: The Case of Housing New Zealand Corporation

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## 2) Purpose

This paper is about the methods we used to ensure the effective management of the Crown's investment in Housing New Zealand Corporation (HNZC) through the development and implementation of good governance and accountability frameworks that allow a balance between flexibility for HNZC and central control and monitoring.

The paper is in 4 parts:

- Part 1 sets the scene and describes why HNZC was established as a Crown entity and outlines issues arising from its governance arrangements.
- Part 2 describes the governance and accountability arrangements established in order to allocate, manage and monitor investment in HNZC with Part 3 looking at the tools developed in more detail.
- Part 4 considers lessons learnt and issues for the future.

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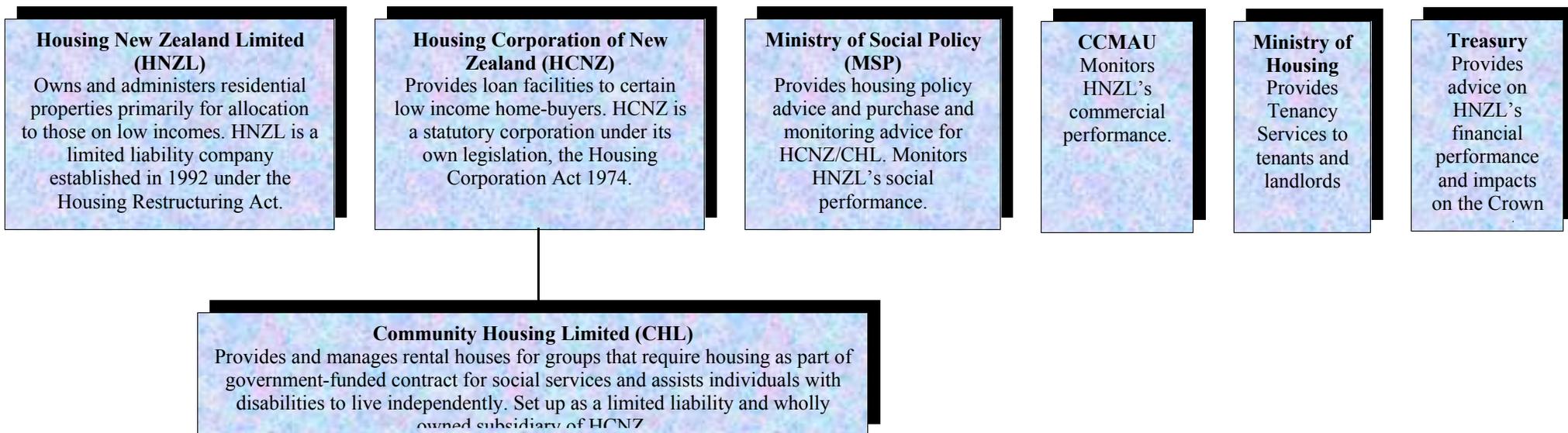
## 4) Part 1: **Setting the Scene**

### a) An Integrated Housing Agency

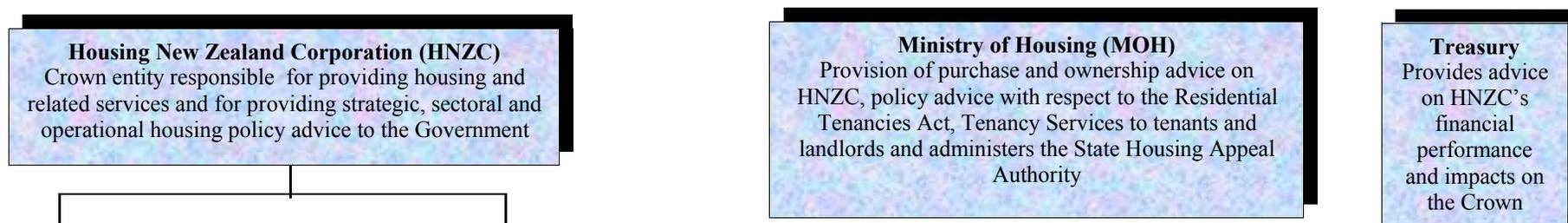
Housing New Zealand Corporation (HNZC) came into being on 1 July 2001. It integrates the former Housing New Zealand Limited (HNZL), Housing Corporation of New Zealand/Community Housing Limited (HCNZ/CHL) and the housing policy function (formerly at the Ministry of Social Policy) into one organisation that is accountable for delivering housing and related services and for providing advice on housing policy. The merger is shown diagrammatically on page 2.

The merger created a single organisation responsible for delivering integrated housing services and linked policy advice more closely with operational activities. While HNZC is accountable for the provision of strategic, sectoral and operational housing policy, accountability for policy advice on the Residential Tenancies Act was given to the Ministry of Housing because of potential conflicts with HNZC's role as the largest residential landlord in the country.

## Agencies with an Interest in Housing in New Zealand (Pre 1 July 2001)



## Current Government Agencies with an Interest in Housing in New Zealand (Post 1 July 2001)



**Housing New Zealand Limited (HNZL)**  
 Holds ownership of the state rental housing assets. Has a number of subsidiaries

**Community Housing Limited (CHL)**

statutory corporation was established in the fourth, fifth, sixth and seventh schedules to the Public Finance Act 1989.

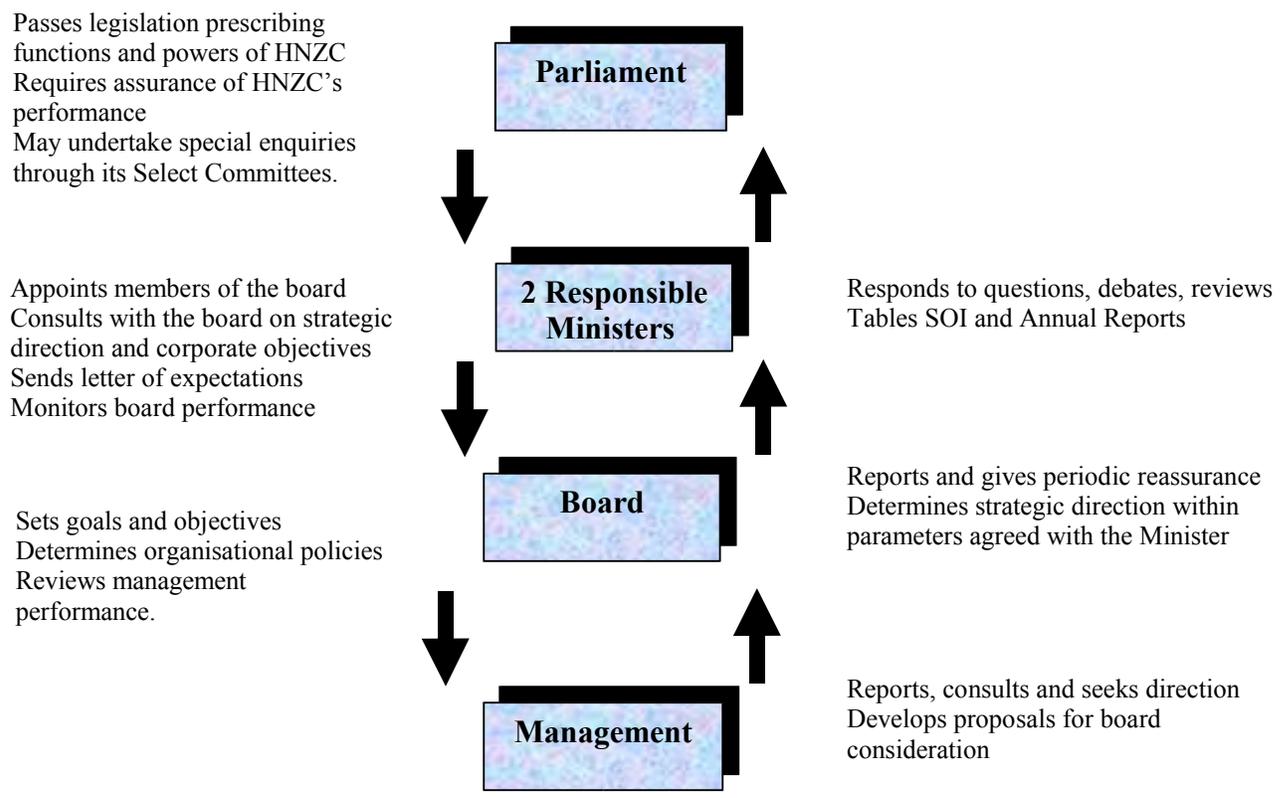
and seventh schedules to the Public Finance Act 1989.

There were several financial reasons why the Government designed the integrated housing agency as a Crown entity. These were:

- to retain HNZL’s commitment and success at operating a commercial organisation in a businesslike manner. The new entity was charged with operating with good financial management, oversight and stewardship in its efficient administration of the Crown’s investment;
- to ensure the financial implications of the change in organisational structure did not have an adverse impact on bondholder perceptions (HNZL had a significant level of foreign borrowing (external debt) pre-1 July 2001); and
- to minimise the impact on the Crown balance sheet (HNZL’s assets are currently valued at approximately \$7b).

**c) Governance Arrangements**

The governance framework for HNZC consists of four key parties – Parliament, Ministers, the Board and the management team. Diagrammatically this can be shown as:



The Ministers of Housing and Finance both have responsibilities with respect to HNZC. Within this model, the Ministry of Housing is accountable for providing Ministers with governance, purchase and monitoring advice related to HNZC. The Treasury's interest is in the financial performance of HNZC and on issues relating to HNZC that impact on the Crown's balance sheet, operating statement, cash flow and risk profile.

d)

**e) HNZC's Funding**

HNZC is funded through a mix of rental income from tenants (estimated at \$300m in 2003/04), Crown compensation to HNZL for the difference between income and market-related rents (estimated at \$328m in 2003/04) and specific appropriations from the Crown (approximately \$215m in 2003/04).

HNZC's current financing arrangements are a short-term debt facility (commercial paper and overnight borrowings) to fund working capital requirements, private sector debt (which is being refinanced with Crown debt as it matures), and Crown debt (which is refinanced as it matures). Although HNZL was able to borrow from the private sector, all new debt taken on by HNZC is borrowed from the Crown as approved by the Minister of Finance.

**f) Issues Raised by this Institutional Arrangement**

The organisational and governance arrangements put in place with the establishment of HNZC raised a number of issues including:

*Achieving a balance between flexibility and control*

- One of the reasons for establishing an organisation as a Crown entity rather than a department is to provide greater operational freedom. This raises issues of how to maximise the benefits of the Crown entity model and at the same time manage the risks that this creates for the Crown.

*Uncommon institutional arrangements*

- Placing the provision of strategic, sectoral and operational policy advice in a Crown entity is not common and raises a particular set of governance challenges such as the role of the Board in the provision of policy advice. The decision to make the Corporation responsible for housing policy raised capability issues for the new entity. HNZC had to increase its capacity and capability to provide advice to Cabinet on housing policy and to enhance staff understanding of Cabinet systems and processes.
- The provision of purchase advice and vote administration became the responsibility of the Ministry of Housing. It is unusual for these functions to sit in a different organisation to the policy function.

### *Social obligations in a businesslike manner*

- HNZC was set up to achieve social objectives in a businesslike manner. This raised key questions about defining what businesslike means, what constitutes good financial performance and how to measure both. The appropriate capital structure for the organisation was also raised.
- Moving from a primarily commercial decision-making framework to one that also achieves social objectives means that HNZC may need to provide housing where the commercial financial return is not met. Under the previous model, HNZL had applied a decision-making framework that compared an investment's internal rate of return (IRR) to the company's weighted average cost of capital (WACC) to ensure investment in housing was cost-effective. In moving to a more socially-focused organisation, there was an absence of social investment decision criteria.

### *New funding arrangements*

- The requirement for all of HNZC's primary borrowing (excluding its working capital facility) to be obtained from the Crown meant that a borrowing protocol between the Corporation and Debt Management Office (DMO) in the Treasury was needed.
- The need to deliver an increased range of social programmes led to an increased reliance on Crown appropriations. Although HCNZ/CHL did have some appropriated funding HNZL did not (until the last year of its existence) and so did not have experience in the Budget process and matters associated with vote administration. The fact that the Corporation's capital appropriations have been administered through Vote Finance and its associated operating ones through Vote Housing is an added complexity. This is due to change on 1 July 2003 when all appropriations to HNZC will come through Vote Housing.

### *New players with new roles and responsibilities*

- The transfer of responsibility for providing governance, purchase and monitoring advice to the Ministry of Housing meant that this agency needed to develop its capability in terms of people, knowledge, systems and processes, relationships and networks.
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## **5) Part 2: Establishing the Governance and Accountability Arrangements Necessary to Allocate, Manage and Monitor Investment in HNZC**

### **a) The Objectives of the Framework**

Part One of this paper introduced the issues we needed to consider when developing a governance and accountability framework that ensures that investment in HNZC is allocated, managed and monitored effectively. To be effective the framework needed to:

- Define clear roles and responsibilities and ensures constructive relationships based on these roles.
- Include an accountability system that:
  - sets clear performance expectations i.e. *what* (outputs) HNZC is seeking to do, *why* (outcomes) and *how* (capability).
  - includes a monitoring regime that reflects the balance between the autonomy of HNZC's board and the interests of Parliament and the Crown.
  - sets clear expectations about the circumstances under which the board needs to consult the Minister or seek agreement to a proposal that may materially affect the Crown's interest.
- Strike an appropriate balance between flexibility for HNZC and central control and monitoring
- Allow for transparency in decision-making;
- Be workable;
- Be easy to understand;
- Reflect relevant legislation;
- Take account of best practice;
- Contain clear processes and timeframes.

### **b)**

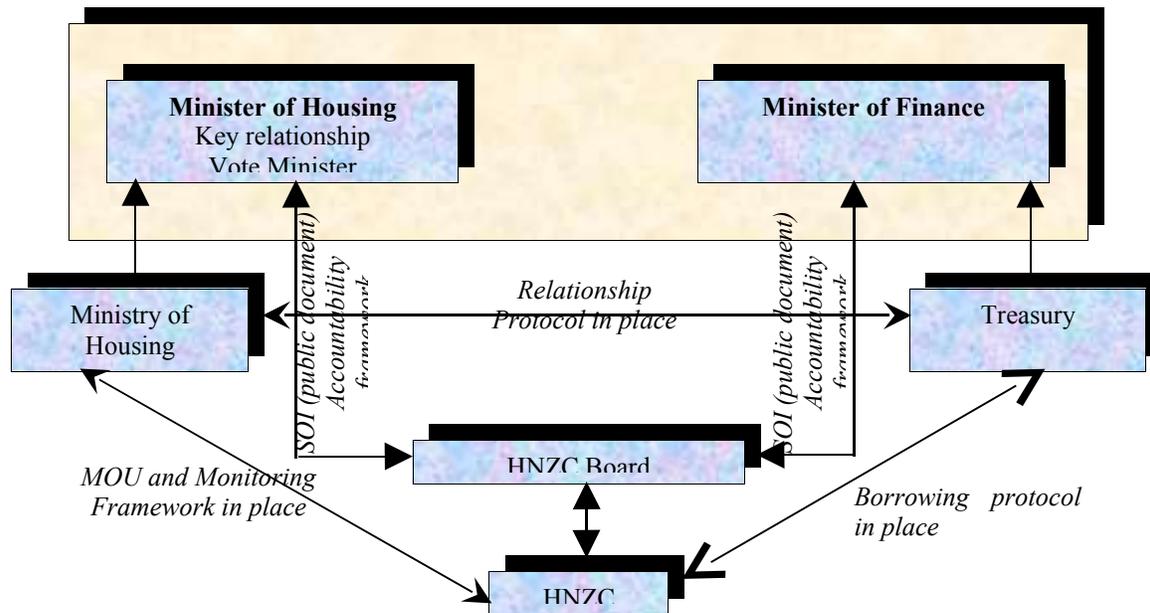
### **c) The Framework**

The key elements of the framework developed include:

- A Statement of Intent and other accountability documents
- A Memorandum of Understanding between HNZC and Ministry of Housing
- A Monitoring framework focused on who does what, what gets monitored and why, how information is recorded and when and how the parties deal with each other

- An ‘accountability framework’ that sets out the roles of the respective Ministers, the board and advisers and outlines when Ministers expect to be consulted or take the investment decision. Ministers formally advised the Board of this framework. This includes a decision-making framework that covers investment decisions aimed at meeting social need that do not meet the required rate of return.
- A relationship protocol between the Ministry of Housing and the Asset and Liability Branch of the Treasury which defines the roles and responsibilities of the monitoring agencies and sets out the issues that each agency needs to be involved in and which agency will take the lead on various issues.
- Arrangements to cover policy development within a Crown entity with a Board.
- Arrangements to manage the provision of purchase advice and the co-ordination of the Budget process across the housing sector.
- When HNZC was formed, a borrowing protocol was agreed between it and the Minister of Finance under section 30 of the Housing Corporation Act 1974. This protocol sets out the conditions and expectations for HNZC borrowing. It specifies that all new HNZC primary borrowing (excluding the working capital facility) must be obtained from the Debt Management Office (DMO) in the Treasury i.e. the Crown.

These arrangements are shown diagrammatically below.



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## **7) Part 3:**

### **A Closer Look at the Tools**

#### **a) Statement of Intent and Other Accountability Documents**

As with a majority of Crown entities, HNZC's performance expectations are set through its Statement of Intent (SOI). How the Corporation spends its money is largely reliant on the SOI process. In this public accountability document, HNZC sets out how it will balance businesslike management with its social delivery objectives. The Ministry of Housing and the Treasury take an active interest in the SOI process and take a collaborative approach to the negotiation of this document. The monitoring agencies review the supporting business and asset management plans as part of this process.

#### **b) Memorandum of Understanding between HNZC and the Ministry**

This agreement provides the framework for an ongoing relationship between the Ministry of Housing and HNZC. It sets out the principles that we intend to guide the working relationships between our two organisations. These are:

- Good faith
- No surprises
- Constructive collaboration
- Early consultation
- Professional trust and respect for each others roles
- Collaboration on mutual issues

It also sets out that the two organisations agree to:

- work in accordance with the monitoring framework which is attached to the document;
- respect the boundaries between the Ministry as agent of the Minister and HNZC as an independent Crown entity;
- discuss relevant issues between agencies prior to raising issues with Ministers;
- inform each other of matters that may affect the other in carrying out their role;
- share information or consult regularly on matters of mutual interest; and
- discuss issues openly with the aim of clarifying the situation and identifying remedial action if required.

The document sets out how the relationship will be managed and includes provision for regular face-to-face meetings at various levels. It sets out the information that will be shared and how information requests will be managed.

The document is signed by the Ministry's Chief Executive and the Chair of the HNZC's Board. Responsibility for implementation sits with the Chief Executives of the two organisations and the day-to-day management of the relationships is the responsibility of the Ministry's Chief Adviser and HNZC's General Manager Strategic Services.

### **c) Monitoring Framework**

A monitoring framework was agreed between the Ministry and HNZC as part of the MOU between the two organisations. This framework guides the monitoring relationship and establishes how information will be shared.

The key elements of the monitoring framework are:

- Roles and responsibilities                      who does what
- Performance expectations                      what gets monitored and why
- Documents and processes                      how information is recorded and when
- Relationships                                      how the parties deal with each other

#### *Roles, responsibilities and relationships*

For the governance of HNZC to be effective it is important that each of the parties involved clearly understands their own role and those of the other parties and that there are constructive relationships based on these roles. These are often unclear in the Crown entity framework. The monitoring framework and associated accountability framework attempt to clarify the roles of the various players.

Good professional working relationships between these agencies are also fundamental to success. Close working relationships and protocols that articulate the roles of each and set out the basis for the relationship have been developed between the respective agencies.

### **d) Accountability Framework**

This framework clearly sets out that the board is expected to consult the Minister(s) about proposals from HNZC that are potentially controversial; and/or have significant policy and/or regulatory implications; and/or are fiscally significant.

To balance flexibility for HNZC and central control and monitoring, the accountability framework sets out where and when Ministers are to be involved in investment decisions. It recognises that HNZC may need to make some investments at a lower return than might otherwise be expected to meet its social objectives but that it would be neither desirable nor appropriate for Ministers or the monitoring agencies to be involved in these individual decisions e.g. purchase of an individual house that does not meet HNZC's WACC. The framework restricts this type of activity to a previously agreed limit to manage the risks from the Crown's point of view and to provide guidance for the Board.

### **e) Policy arrangements**

The MOU/monitoring framework clearly sets out that HNZC's board is responsible for ensuring the performance of the Corporation in relation to its policy advice function but is not responsible for advising on government policy or on the content of budget

bids. It also sets out processes for developing and renegotiating the policy work programme.

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## **8) Part 4: Future Issues - The Evolving Relationship**

This paper describes a framework that was developed and implemented in 2001/02, with a particular set of players to address establishment issues. Two years on, some of the initial teething problems have been addressed and other, new issues have emerged.

There is a new Minister of Housing and new Chief Executives in both HNZC and the Ministry. It is timely to review the framework and its operation. In doing this we will ensure that we retain its strengths and keep it current to address the issues of today.

No frameworks last forever, they need to evolve as the environment changes. No framework can work well without good relationships. Structured frameworks are good as far as they go but reality is generally messier and frameworks can only ever be tools to try and simplify reality – they are not themselves reality.