

Hon Robertson
ORIGINAL

Tertiary Education
Commission
Te Amorangi Mātauranga Matua



Tertiary Education Report: Further Crown support for Tai Poutini Polytechnic

Date:	6 March 2020	TEC priority:	High
Security level:	In Confidence	Report no:	B-20-00093
		Minister's office No:	

ACTION SOUGHT		
	Action sought	Deadline
Hon Chris Hipkins Minister of Education	<p>agree to provide a \$5 million capital injection to Tai Poutini Polytechnic to ensure it can meet its operating commitments in 2020.</p> <p>sign two copies of the attached amendment to the Crown funding agreement.</p> <p>forward this briefing and the funding agreement amendment to the Minister of Finance for his agreement and signature.</p>	As soon as practicable
Hon Grant Robertson Minister of Finance	<p>agree to provide a \$5 million capital injection to Tai Poutini Polytechnic to ensure it can meet its operating commitments in 2020.</p> <p>sign two copies of the attached amendment to the Crown funding agreement.</p>	27 March 2020
Enclosure: Yes		Round Robin: Yes

CONTACT FOR TELEPHONE DISCUSSION (IF REQUIRED)			
Name	Position	Telephone	1st contact
s9(2)(a)	Principal Advisor	s9(2)(a)	✓
Gillian Dudgeon	Deputy Chief Executive, Delivery	s9(2)(a)	

THE FOLLOWING DEPARTMENTS/AGENCIES HAVE SEEN THIS REPORT

- DPMC MPI ENZ ERO MBIE MoE MFAT
 MPP MSD NZQA NZTE TEC TPK Treasury

- Minister's Office to Complete:**
- | | |
|---|--|
| <input type="checkbox"/> Approved | <input type="checkbox"/> Declined |
| <input type="checkbox"/> Noted | <input type="checkbox"/> Needs change |
| <input type="checkbox"/> Seen | <input type="checkbox"/> Overtaken by Events |
| <input type="checkbox"/> See Minister's Notes | <input type="checkbox"/> Withdrawn |

Comments:

Recommendations

Hon Grant Robertson, Minister of Finance, **Hon Chris Hipkins**, Minister of Education

It is recommended that you:

1. **note** that in November 2019 Cabinet agreed to reallocate \$5 million from the Non-Departmental Capital Expenditure appropriation "Support for Lincoln University" in Vote Tertiary Education to the "Support for Tai Poutini Polytechnic" appropriation to support the viability of Tai Poutini Polytechnic (TPP) over 2020 [GOV-19-MIN-0046 refers];
2. **note** that Cabinet authorised the Minister of Finance and the Minister of Education to jointly approve a capital investment of up to \$5 million to TPP, and to finalise any related terms and conditions;
3. **agree** to provide a \$5 million capital injection to TPP to ensure it can meet its operating commitments for most of 2020 and continue to provide tertiary education on the West Coast as it transitions to the New Zealand Institute of Skills and Technology (the Institute);

Minister of Education

AGREE / DISAGREE

Minister of Finance

AGREE / DISAGREE

4. **note** that on 1 April 2020, TPP will become a Crown Entity subsidiary of the Institute, which will become responsible for offering a mix of education and training in each region (including the West Coast) that meets the needs of its learners, industries and communities as part of a viable national network;
5. **note** that we consider it critical that the Institute make changes at TPP and leverage off other parts of the institute of technology and polytechnic network to improve the viability of TPP's delivery;
6. **note** that this capital injection is only sufficient to ensure TPP can meet its operating costs through to late 2020 and further support is likely to be required to manage TPP's ongoing viability;
7. **note** that a funding agreement between the Crown and TPP was signed in March 2018 by the Minister of Finance, the Minister of Education and the Crown Manager of TPP, and the attached amendment to the funding agreement sets out the terms and conditions of the additional \$5 million capital injection to ensure accountability for funding;
8. **sign** two copies of the attached amendment to the funding agreement;
9. **forward** copies of the agreement and this briefing to the Minister of Finance for his consideration and decision;
10. subject to the agreement of the Minister of Finance, **send** the signed copies of the amendment to the funding agreement to the Crown Manager of TPP alongside the attached letter;
11. once TPP return the signed funding agreement, **sign and send** the attached letter to the Secretary for Education requesting the \$5 million payment be paid;

12. **agree** that the Tertiary Education Commission proactively release this briefing once decisions have been made with commercially sensitive information and the amendment to the funding agreement withheld to enable TPP to carry on, without prejudice or disadvantage, negotiations (including commercial and industrial negotiations);

Minister of Education

AGREE / DISAGREE



Gillian Dudgeon

Deputy Chief Executive, Delivery
Tertiary Education Commission

6 March 2020



Hon Chris Hipkins

Minister of Education

10 / 3 / 20



Hon Grant Robertson

Minister of Finance

23 / 3 / 20

Purpose

1. The purpose of this briefing is to seek joint Ministers' agreement to provide a \$5 million capital injection to Tai Poutini Polytechnic (TPP) to ensure it can continue to operate for most of 2020 and to support its transition to the New Zealand Institute of Skills and Technology (the Institute).

Background

TPP is not financially viable...

2. We have previously briefed Ministers on the situation at TPP, its financial issues, and its lack of ongoing viability. The strategic options business case submitted to Ministers by the Crown Manager of TPP, Murray Strong, in November 2017 was clear that TPP could not survive without ongoing Crown support. It noted that even if structural changes were made to TPP, a regional remote subsidy would still be needed to account for the higher costs of providing tertiary education on the West Coast and to ensure the financial sustainability of tertiary education in the region. The West Coast has particular challenges for the delivery of tertiary education due to its small population which is spread over a large geographic area (even compared with other regional polytechnics).

...and it has been reliant on ongoing Crown support since early 2017

3. The Crown has provided ongoing financial support to TPP over the past three years to ensure it could meet its operating commitments and provide provision on the West Coast. This has included Crown capital injections of: \$3.6 million in April 2017; \$8.5 million in three instalments over 2018; and \$2.25 million in August 2019. In addition, the TEC Board agreed in 2018 to write-off a \$24.9 million debt owed to the TEC by TPP (comprised of \$21.2 million from a 2015/16 investigation and \$3.7 million from under delivery against its 2016 funding allocation).
4. When Ministers agreed to provide a \$2.25 million capital injection in July 2019, we signalled further Crown support would be required for TPP in 2020 (B-19-00882 refers).

Recent performance

TPP has reported another significant deficit for 2019...

5. TPP reported an unaudited deficit of \$7.8 million for 2019, which equates to 145% of revenue. The result is an improvement on its \$11.6 million deficit for 2018 but significantly worse than its 2019 budget of a \$2.4 million deficit. The worse than budget result is largely due to lower than expected enrolments and \$2.5 million in transformation costs that had not been appropriately accounted for in its budget. The transformation costs mainly relate to staffing its project management office, professional services, Crown Manager costs, and staff redundancies in relation to contractual obligations of the transfer of the Music and Audio Institute of New Zealand (MAINZ) to the Southern Institute of Technology (SIT).
6. Lower than expected enrolments in 2019 resulted in revenue being 46% below budget. While TPP has managed to further reduce costs in response to lower EFTS, management has not been able to reduce them as much as the shortfall in EFTS.

...as its delivery continues to be refocussed on the West Coast...

7. Over the past two years, enrolment numbers at TPP have fallen sharply – from nearly 2,000 EFTS in 2017 to 902 EFTS in 2018 and only 320 EFTS in 2019. The majority of the reduction is due to either non-West Coast delivery ceasing or the delivery being transferred to another provider (e.g. MAINZ being transferred to SIT and scaffolding delivery being transferred to industry training organisations). Furthermore, following TEC's 2015/16 investigation, a number of qualifications were found to be oversized and had to be reduced to an appropriate EFTS level, which further reduced overall EFTS delivery.

8. In terms of West Coast delivery by TPP, it has fallen from 377 EFTS in 2017 to 214 EFTS in 2019. In 2019, around two-thirds of TPP's EFTS were being delivered on the West Coast compared to 19% in 2017. Some of the decline in West Coast EFTS is due to delivery being transferred to other providers, however, demand for training appears to remain weak – potentially due to the low unemployment rate on the West Coast and no population growth. A number of programmes were not run in 2019 due to low enrolment numbers – including hair, beauty and grooming; computing; pre health; and science. TPP has also reduced the number of short courses it offers to ensure quality standards are met and that they align to the region's training requirements.
9. TPP's educational delivery is now all foundational and lower-level vocational qualifications. TPP last taught degree-level qualifications in 2017 and Level 6 diplomas or graduate certificates in 2018. TPP continues to deliver the vast majority of tertiary education provision on the West Coast accounting for 87% of overall tertiary delivery at West Coast delivery sites.

...and TPP is expected to report another large deficit in 2020...

10. TPP has budgeted for a deficit of \$6.8 million, or 108% of revenue, in 2020. TPP has prepared its budget assuming no changes from becoming a subsidiary of the Institute given uncertainty around what changes will actually occur in 2020.
11. Compared to its draft 2019 results, TPP expects a \$1 million increase in revenue on the back of enrolment growth with SAC-funded EFTS budgeted to increase from 216 to 246 EFTS. However, TPP also expect a \$1.2 million increase in expenditure due to increased delivery costs (on the back of assumed higher enrolments), increased marketing and maintenance costs, as well as an increase in staffing costs to fill capability gaps in finance, human resources, and academic quality for a planned external evaluation and review (EER) by NZQA in November 2020. Despite reducing from 2019, TPP has still budgeted for \$1.3 million in transformation costs related to its Chief Executive, Project Management Office, exiting leases and relocations costs (which accounts for \$0.4 million), and continued support for academic capability and quality development.
12. No capital expenditure is being undertaken by TPP aside from that required to deliver teaching or meet health and safety requirements (budgeted at \$0.4 million in 2020). All other capital expenditure and maintenance has been deferred. While this will continue to support TPP's financial position in the short-term, it is not a viable long-term strategy.

...but we consider that there is a high risk that the result will be worse...

13. Nearly all of the risks to TPP's 2020 budget are on the downside. These include:
 - *Enrolments being lower than expected* – this is the greatest risk to TPP's revenue forecast given the forecast increase in enrolments does not appear to be based on any real strategy, there is weak demand in the region, and the limited pool of potential students which TPP recruits from. We consider this risk has a high chance of occurring.
 - *Limited ability to further reduce costs* – while TPP has expense management policies in place, it has removed significant costs, particularly staffing, over recent years. Although further reduction could potentially occur, there is a base level of staffing and capability required to run an ITP and meet delivery expectations. However, we do have some concerns about the budgeted increase in expenditure.
 - *Unexpected capital expenditure* – TPP has been deferring capital expenditure for some time now given its financial issues and there is a risk that urgent capital expenditure as a result of historical deferred maintenance issues may arise.
 - *Meeting any costs relating to integration into the Institute* – the 2020 budget is based on TPP's current operating model and does not include any potential costs that may need to be met as part of becoming a subsidiary of the Institute.

- *Staff capability issues* – management continues to struggle to recruit staff with appropriate capability to key positions and is heavily reliant on a few individuals. There is a strong risk to TPP and its ability to best manage its financial situation if key staff leave. This is especially relevant in the current environment and the lack of certainty to staff roles post-integration to Institute.
14. TPP continues to closely monitor its financial performance on a weekly basis, updating cash flow forecasts and applying continued tight cost control measures to reduce spending. However, its ability to deal with any adverse shocks is limited.
 15. TPP has extremely limited delivery to international students so COVID-19 is not anticipated to negatively impact its performance. In 2019, only 1% of TPP's delivery was to international students from Asia.

...as TPP continue to focus on improving quality and meeting stakeholder and regional needs

16. Despite its financial issues, TPP continues to make progress on becoming a more student centric organisation and ensuring that vocational education and training on the West Coast is high-quality, accessible, and meets the needs of students and employers. Work is continuing on improving staff capability and academic quality, while TPP continues to improve its collaborative relationships with other tertiary providers (e.g. Te Wānanga o Aotearoa and Open Polytechnic) to reduce costs and support improved quality of delivery on the West Coast. TPP has also been in discussions with Unitec to co-locate TPP's Auckland-based scaffolding delivery on the Unitec campus.
17. TPP continues to actively engage with job-seekers and employers on the West Coast as part of identifying the region's skills and training needs and delivering programmes to meet these needs (e.g. conservation, tourism, and small business management). Historical programmes that did not align with the training requirements of the region have been discontinued, although this has also had the effect of negatively impacting revenue.

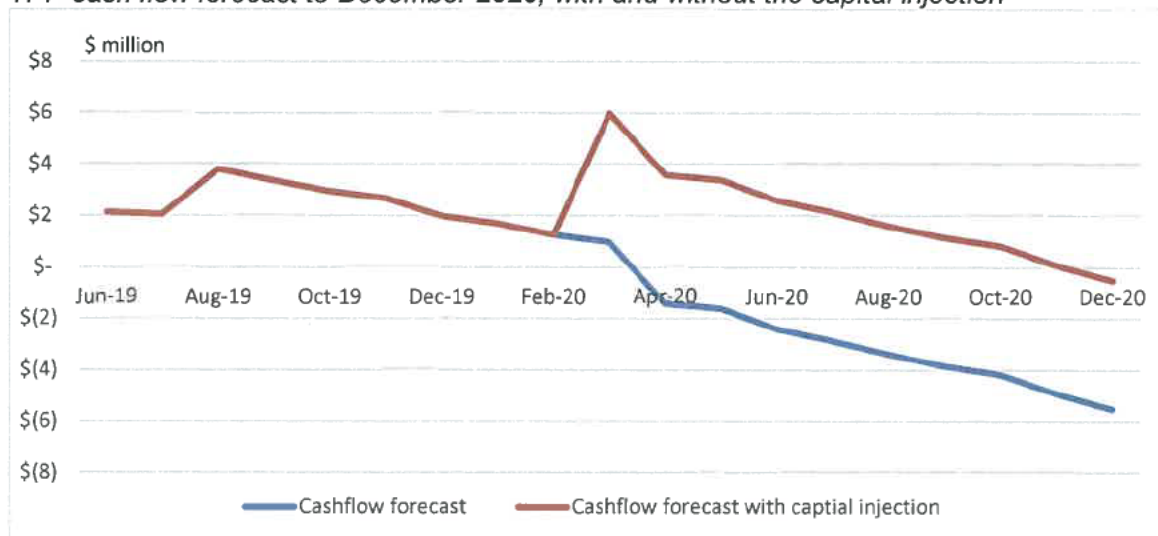
Cash flow forecast and Crown support

TPP's cash position remains extremely tight...

18. TPP finished 2019 with around \$2 million in cash. However, this did not include a recovery from the TEC of around \$1.8 million for under-delivery against its 2019 funding allocation. We agreed to delay any recovery until April 2020 to support TPP's cash position. If TEC had recovered the under-delivery before the end of 2019, TPP's cash balances would have only been \$0.2 million at the end of the year and it would have had issues meeting its financial commitments.
19. TPP's latest cash flow forecasts indicate it will run out of cash by April 2020 if no Crown support is provided. We therefore seek a decision to provide Crown support by the end of March 2020 to reduce any liquidity risks for TPP.

...and \$5 million in Crown support will ensure TPP remains viable for most of 2020...

20. The latest forecast suggest that a \$5 million capital injection should ensure TPP remains cash positive for the majority of 2020 and give sufficient time for the Institute's Council to make decisions on the future of TPP's provision and manage its ongoing viability. However, much is dependent on enrolment numbers for 2020, which tend to be progressive rolling enrolments rather than the semester structure more common with the larger ITPs. Typically we have not had a good indication of full-year enrolments at TPP until well into the second half of the year.
21. The graph on the following page shows TPP's cash flow forecast, with and without the \$5 million Crown capital injection.

TPP cash flow forecast to December 2020, with and without the capital injection

...and joint Ministers' sign off is required to authorise the capital injection...

22. In November 2019, as part of the Cabinet paper to confirm Crown capital investment to support the rebuild of Lincoln University's science facilities, Cabinet agreed to reallocate \$5 million to support TPP [GOV-19-MIN-0046 refers]. Cabinet also delegated authority to the Minister of Finance and the Minister of Education to jointly approve a capital investment of up to \$5 million to TPP and finalise any related terms and conditions.
23. This paper seeks agreement from the Minister of Finance and the Minister of Education to make payment of \$5 million to TPP. Failure to provide funding will result in TPP not being able to pay its expenses. This would result in some learners being unable to continue their studies given TPP is the only provider of broad-based tertiary education on the West Coast.

...while amending the existing funding agreement will provide accountability for funding

24. A funding agreement between the Crown and TPP was established as part of the \$8.5 million capital injection to TPP, which was signed by the Minister of Finance and the Minister of Education on behalf of the Crown in March 2018 (B/18/00114 refers). An amendment to that funding agreement to cover the additional \$2.25 million capital injection in 2019 was signed in July 2019 (B-19-00882 refers). The latest progress report from TPP shows that all of the targets agreed as part of that funding agreement amendment have been achieved or are on track to be achieved.
25. We have drafted another amendment to the funding agreement and attached it to this briefing for consideration and signature from the Minister of Finance and the Minister of Education. The Treasury, the Ministry of Education (MoE) and TPP have been consulted in the development of the amendment.
26. The amendment sets out targets for 2020 which we have developed in conjunction with the Crown Manager and Chief Executive of TPP. These complement and build off the actions and targets that were agreed as part of the previous funding agreement around improving financial performance, academic quality, and meeting the needs of the West Coast. They have been developed within the context of the transition to the Institute and is why we have agreed only a limited number of targets.
27. The amendment will require TPP to provide quarterly milestone reports to the TEC outlining progress against the targets as well as providing a range of enrolment, financial and cash flow reporting, and a breakdown of expenditure funded by the capital injection. These reporting requirements will continue even after TPP becomes a subsidiary of the Institute on 1 April 2020.

Future of delivery on the West Coast

The long-term future of tertiary education on the West Coast is linked to RoVE...

28. TPP is clearly not viable in its current form under the current funding system. This partly relates to the higher costs of providing tertiary education on the West Coast but is also a consequence of TPP's complete lack of scale. At 320 EFTS, it is less than one-quarter of the size of the next smallest ITP – Western Institute of Technology at Taranaki (1,463 EFTS in 2019) – which also has financial sustainability issues.
29. While over recent years, under the guidance of the Crown Manager, TPP has managed to significantly reduce costs, there remains a base level of expenditure needed to run an ITP head office and ensure quality of delivery. Essentially, TPP has most of the fixed costs of an ITP but none of the scale to spread these costs over.
30. Given TPP's lack of viability, the long-term future and financial sustainability of tertiary education on the West Coast is closely linked to the reform of vocational education (RoVE).
31. On 1 April 2020, TPP will become a Crown Entity subsidiary of the Institute and the Institute will become responsible for improving the viability of TPP's delivery and meeting the needs of the West Coast and its learners. However, in the short-term, the Institute will not have the scale, capabilities, or systems to ensure viable provision on the West Coast. Indeed, while consolidation and other changes may generate some efficiencies, financially sustainable provision on the West Coast is unlikely without significant changes and increase in revenue. There are high expectations that the latter will result from the implementation of the Unified Funding System from 2023.

...however, the Institute can still make changes to improve financial performance

32. Despite this, we consider it critical that the Institute's Council makes decisions on the future of TPP and how to reduce its financial drain on the Institute as soon as practicable after 1 April 2020. As above, while it is unlikely that it can make provision viable on the West Coast, we consider that the Institute should be able to at least reduce the size of its deficit through leveraging off other capability in the sector. This could include back office support/capability or support in programme delivery – for example, increasing its relationship and collaboration with Open Polytechnic or utilising other South Island providers for focused “fly-in” delivery.
33. This is an issue we will look to engage with the Institute's Council and senior management on. The Minister's Letter of Expectations to the Institute's Council and the funding agreement between the Crown and the Institute will also make clear expectations around managing and using the ITP network as a whole and taking advantage of rationalisation where possible.
34. Failure to make any changes will see additional, and ongoing, Crown capital funding required by the Institute to manage TPP's ongoing viability. Based on cash flow forecasts, additional funding would be needed by around November 2020 if no changes are made – earlier if enrolments are significantly lower than expected. TPP in its current form appears to require around \$5 to \$7 million in additional capital funding each year (more than its total revenue) to ensure its ongoing viability.
35. As part of the Government's funding package to support the establishment of the Institute, it is proposed that \$50 million in Crown funding is set aside in a contingency to manage any potential cash shortfalls in the Institute's subsidiaries. This funding will be able to be drawn down by the Institute on approval from the Minister of Finance and the Minister of Education. It is almost certain that the Institute will seek to draw down funding from this contingency to ensure TPP's ongoing viability. However, we will want to ensure that the Institute is taking appropriate actions to manage the ITP network and make improvements through collaboration where possible before providing additional funding.

Next steps

36. If you agree to provide the \$5 million in Crown funding to TPP, the following actions are required:
- sign two copies of the amendment to the funding agreement attached to this report;
 - send this briefing and the amendment to the funding agreement to the Minister of Finance for his agreement and signature;
 - once signed by the Minister of Finance, send the attached letter and signed funding agreements to the Crown Manager of TPP for his signature; and
 - once a signed copy of the funding agreement has been returned to you, sign and send the attached letter to the Secretary for Education authorising the \$5 million payment.
37. We will assist the Minister of Education's office with any public communications as required.