Tertiary Education Commission
Te Amorangi Mātauranga Matua

Aide-Memoire: Financial modelling of ITP performance

To:	Hon Penny Simmonds, Minister for Tertiary Education and Skills
From:	Tim Fowler, Chief Executive, Tertiary Education Commission
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Purpose

1. This paper provides you with an overview of the initial financial modelling we have undertaken alongside Te Pūkenga, on the future financial performance of the former institutes of technology and polytechnics (ITPs). Its purpose is to highlight the financial viability challenges facing most ITPs and to help support decisions that you will need to make on the design and funding of the future vocational education and training sector.

Executive summary

2. Te Pūkenga budgeted for its former ITP business divisions ("former ITPs") to report a $127 million deficit in 2024, which includes $23 million in business division cost savings. The key findings from the recent modelling undertaken include:

9(2)(b)(ii) [redacted]

- There are a range of costs that are currently centralised and incurred by head office (e.g. legal fees, insurance costs) as well as certain functions that are now undertaken by head office (i.e. finance and property). There are also additional costs that need to be met to re-establish independent ITPs. 9(2)(b)(ii) [redacted]

9(2)(b)(ii), 9(2)(g)(i) [redacted]

9(2)(g)(i) [redacted]

- This financial modelling is high-level and there is considerable uncertainty around future viability and Crown funding requirements until other policy and operational decisions are made.

Background

3. Over the past two weeks we have worked with Te Pūkenga's Chief Financial Officer and Financial Advisor to develop financial forecasts for all 15 of Te Pūkenga's former ITPs (we have combined WelTec and Whitireia) for 2024, 2025, and 2026. These forecasts primarily focus on financial performance (their net surplus/deficit position). Preliminary commentary is also provided on the impacts of this performance on their respective balance sheets, should they become standalone ITPs. This is to inform your understanding of recapitalisation requirements necessary to ensure any standalone ITP is solvent on establishment.

4. The paper begins by presenting key financial metrics to establish the financial position of ITPs prior to the establishment of Te Pūkenga along with their respective EFTS volumes. This is compared to their performance in 2023 based on unaudited results. Te Pūkenga's 2024 budget is then presented (with the current unified funding system (UFS) rates) as well as forecast performance in 2025 and 2026 9(2)(f)(iv) [redacted]

5. The outputs provided below are from the first stage of modelling based on the information available to us currently. As decisions are made around the structure, operation, and funding of the new vocational and education training system, further and more detailed modelling will need to be undertaken – particularly to inform Crown funding requirements.

Financial performance between 2019 and 2023

Many parts of the sector were having financial issues in 2019…

6. Prior to the establishment of Te Pūkenga, the ITP sector was experiencing significant financial difficulties. Financial performance had deteriorated over the preceding decade for a variety of reasons including a strong labour market, increased competition, demographics, immigration policy changes, and minimal increases in tuition subsidies.

7. Between 2016 and 2019, the ITP sector experienced a significant reduction in enrolments. SAC and Youth Guarantee (YG) funded EFTS fell by 15 percent while full-fee international EFTS declined by 16 percent due to policy changes around visa settings/work-rights. These declines had a considerable negative impact on revenue and the ITP sector was unable to reduce expenditure by a commensurate amount.

…with the majority of ITPs reporting deficits…

8. In 2019, 10 out of 15 ITPs reported a deficit with the ITP sector as a whole reporting a $49 million loss (see *Table 1*). Of the five ITPs that reported a surplus, only EIT reported a surplus of three percent of revenue or higher.

9. The ongoing poor performance was impacting sector liquidity and reducing cash reserves. In 2019, the ITP sector had a net cash position (cash and short-term investments minus debt) of $175 million. Five ITPs, however, were carrying a total of $97 million in debt, including $43

million in Crown debt. Four ITPs had a negative cash position with several others presenting significant liquidity risks. Three ITPs were also subject to Crown intervention and were receiving Crown capital injections/loans to meet operating commitments (Unitec, Whitireia/WelTec, and TPP). Without this support, the sector's net cash position would have been considerably worse.

Table 1: 2019 financial and enrolment performance

	Revenue	Expenditure	Net surplus/ deficit	Net cash position	SAC/YG EFTS	Full-fee international EFTS
Northtec	36.3	40.0	-4.8	12.8	1,856	547
Unitec	107.4	120.6	-11.5	-3.5	4,643	1,093
MIT	95.9	99.1	-5.0	14.1	4,108	842
Wintec	105.4	104.6	-4.1	-20.7	4,059	1,207
Toi Ohomai	90.5	93.4	-4.2	33.8	4,365	1,102
EIT	74.4	72.2	2.2	29.9	3,751	783
WITT	22.3	23.6	-1.3	1.0	1,088	244
UCOL	46.3	46.9	-1.2	5.5	2,554	222
WelTec/Whitireia	92.4	103.5	-15.6	-0.1	4,232	1,100
Open Poly	63.9	63.5	0.4	28.7	5,179	30
NMIT	40.4	41.1	-0.6	18.9	1,939	750
TPP	5.3	10.5	-7.7	2.0	225	6
Ara	115.8	111.8	1.7	47.1	5,767	976
Otago Poly	98.4	96.8	1.6	-14.8	4,103	1,160
SIT	62.4	61.0	1.4	40.1	3,694	808
Total	**1,056.9**	**1,088.5**	**-48.7**	**194.7**	**51,563**	**10,870**

…and financial performance has continued to decline over the past four years…

10. Compared to 2019, nearly all former ITPs are in a worse financial position in 2023 with all having reported deficits based on unaudited results. At a sector level, revenue fell by 15 percent between 2019 and 2023 while expenditure remained flat. There are a variety of reasons that drove these trends, including:

- A 7 percent decline in domestic (SAC/YG) funded EFTS consistent with learner numbers being low when unemployment rates are low.

- A 51 percent decline in full-fee international enrolments due to COVID-19 related border closures and government policy changes.

- The introduction of the UFS which set tuition subsidy rates for campus-based delivery at approximately 85 percent of previous tuition subsidy rates (and between 50 to 70 percent of pre UFS rates for extramural delivery).

- A large proportion of the strategic and learner component funding provided to Te Pūkenga was retained by head office and did not become part of the ITP accounts.

- High inflation, which increased by 21 percent between 2019 and 2023, negatively impacting expenditure. The increase was well above increases in tuition subsidy rates over this period.

9(2)(b)(ii)

[redacted]

[redacted]

13. The former ITPs net cash position is not presented in *Table 2* as the centralised treasury function makes it difficult to analyse the individual balance sheets of former ITPs.

Table 2: Change between 2019 to 2023, and unaudited 2023 surplus

	Revenue	Expenditure	SAC/YG EFTS	Full-fee international EFTS	[redacted]
Northtec	-31%	-13%	-30%	-73%	
Unitec	-15%	-16%	-15%	-30%	
MIT	-16%	-7%	-10%	-61%	
Wintec	-24%	-2%	-12%	-69%	
Toi Ohomai	-25%	-5%	-25%	-69%	
EIT	-6%	3%	-22%	45%	
WITT	14%	31%	-5%	-1%	
UCOL	-9%	17%	-14%	-38%	
WelTec/Whitireia	-29%	-9%	-28%	-80%	
Open Poly	3%	38%	47%	78%	
NMIT	-5%	7%	-4%	-71%	
TPP	-11%	6%	-24%	-54%	
Ara	-5%	4%	-2%	-59%	
Otago Poly	-11%	-1%	-2%	-48%	
SIT	-21%	-3%	-7%	-58%	
Total	**-15%**	**0%**	-7%	-51%	

…even if the UFS had not been implemented

14. We have modelled what the financial outturn would have been if domestic EFTS had been funded under SAC funding rates rather than UFS rates. This essentially returns all strategic and learner component funding from the UFS to domestic tuition funding. Under this scenario, the estimated deficit for the former ITP sector falls to [redacted]. While this is much lower than the [redacted] unaudited deficit reported, it is still a significant deficit equivalent to [redacted] of revenue.

[redacted]

9(2)(b)(ii)

[redacted]

9(2)(b)(ii)

[redacted]

9(2)(b)(ii) [redacted]

20. While the forecast results for 2025 and 2026 show an improving position, *Table 3* overstates respective financial performance as it does not include all costs that are currently centralised and incurred by head office. These total approximately 9(2)(i) [redacted] and cover items such as legal fees, audit fees, insurance costs, and software licences. These costs will need to be borne by the ITP network once individual entities are re-established and may increase given the movement from one single organisation to many.

21. These forecasts also do not allow for the re-establishment of certain functions in ITPs that are now undertaken by head office (finance and property, digital, HR) as well as the re-establishment of senior management teams and Councils. These costs are difficult to estimate as they are dependent on the number and structure of the future ITP network as well as whether a shared services entity is established. However, a conservative estimate would be that this may add an additional 9(2)(b)(ii) [redacted] of expenditure across the network.

9(2)(b)(ii) [redacted]

9(2)(g)(i) [redacted]

9(2)(b)(ii), 9(2)(f)(iv) [redacted]

9(2)(b)(ii), 9(2)(f)(iv)

[redacted]

9(2)(g)(i)

[redacted]

9(2)(b)(ii)

[redacted]

…and further information is needed before we can accurately model future sustainability…

30. It is difficult to accurately model the future sustainability of the ITP sector until further decisions are made around its future structure. Further modelling will need to be undertaken once the following are known:

9(2)(f)(iv)

[redacted]

9(2)(f)(iv)

[redacted]

- 2024 enrolment outcome. By April/May 2024, we will have a good understanding of enrolment trends across the ITPs and the associated financial impact. Early enrolment data suggests Te Pūkenga may experience an increase in domestic funded enrolments in 2024 (compared to a budgeted 4 percent decline). This data also suggests that Te Pūkenga has strong full-fee international growth, which following price increases, would drive increased profitability.

…but we consider a range of changes are likely to be needed to achieve a viable network

31. In our view, to achieve a financially sustainable ITP network will likely require a range of both structural and operational changes. These changes will come at a cost and additional Crown funding is likely to be required to fund them.

9(2)(g)(i)

[redacted]

33. It is too early to provide an accurate assessment of such funding requirements, but our indicative estimate is that an additional [redacted] may be required. This estimate will be refined as further modelling is undertaken and decisions are made.

Recapitalisation of ITPs

Cash shortfalls across the ITPs have been managed by Te Pūkenga's centralised treasury function…

34. Around half of ITPs were in a poor cash position prior to the establishment of Te Pūkenga, facing either imminent or medium-term liquidity challenges. Three ITPs were reliant on Crown funding to ensure they could meet their operating commitments.

35. When Te Pūkenga was established, it created a centralised treasury function to manage the losses being reported across the former ITPs. Cash reserves from WBL and the collective ITP network (with the exclusion of ring-fenced reserves) have been used to offset those former ITPs reporting cash losses (as well as those that had commercial debt when they became part of Te Pūkenga).

…and the establishment of independent entities will require recapitalisation…

36. The re-establishment of individual ITPs (the majority of which will be loss-making without significant change) and the removal of the central treasury function will require most ITPs to be recapitalised to ensure they have sufficient financial resources to meet their obligations as they fall due as independent entities. Determining the exact level of recapitalisation needed is difficult, largely because of the number of unknowns that need to be worked through to understand the future operating state. These decisions will have a large bearing on how the Te Pūkenga balance sheet (both its assets and liabilities), will be reallocated back out to the independent entities, and what additional capital would be required.

37. With any redistribution of assets and liabilities, there will be technical elements to work through (such as funding received in advance by Te Pūkenga for the delivery of services that would then be conducted by the independent entity), but at a high-level view we consider there are two main approaches that could be explored.

38. The first is to take a historical balance sheet view of Te Pūkenga's business divisions. Under this approach, business divisions would retain any assets and liabilities that were contributed to Te Pūkenga's balance sheet. They would also keep any cash reserves they have generated from their operating profits during Te Pūkenga's operation.

39. This approach would see those ITPs that have had to borrow from the network through Te Pūkenga's treasury function (half of all ITPs) requiring additional Crown support as they would have no cash available to fund immediate day to day operations and future funding losses. Some other ITPs would have less than desirable liquidity levels given forecast performance. This approach, however, would see WBL retain its significant cash reserves.

40. The second approach is to take a forward-looking approach and for Te Pūkenga to distribute cash (less ring-fenced reserves) through a targeted, needs based approach. This would see more cash being allocated to the ITPs with trading losses and higher capital investment needs. If we wanted to maintain equity in the distribution of cash, you could pro rata the distribution with the Crown providing a 'targeted top up' for specific ITPs where required. While ring-fenced reserves would be excluded from this process, we consider this approach would require careful stakeholder management with regions as well as industry.

…but we consider the Crown should only provide funding after Te Pūkenga has utilised all of its own financial resources…

41. Our preferred approach would be to take a targeted, needs based approach which prioritises the collective network needs rather than singular independent entities. At this stage, we would not recommend taking an historical balance sheet view as we consider a more nuanced approach is needed. Te Pūkenga is a single legal entity with multiple business divisions rather than being comprised of many individual entities. The creation of Te Pūkenga was designed to create a single, national network that would remove some of the volatility associated with labour market and enrolment impacts on regions and sectors. Profitability was to be managed across the network, not by individual division.

42. Taking a single view approach, a large proportion of Te Pūkenga's cash balances at the end of 2025 (minus ring-fenced reserves) would be available to be used to help recapitalise the future ITPs on establishment. These balances are predominately reported against the WBL business division but some ITP business divisions are also forecast to have positive cash balances.

43. While there would be clear winners and losers in a targeted approach, it will significantly reduce the level of Crown investment needed. However, WBL management and industry are likely to consider that its cash reserves should be retained for use going forward as part of a new entity or entities. While WBL will need to retain some cash reserves for future investment, we do not consider cash balances of this size are required to operate sustainability given its low capital needs. Furthermore, the large majority of this cash has (and will be) earnt while it is part of Te Pūkenga and is the result of government initiatives (Apprenticeship Boost, Targeted Training and Apprenticeship Fund) and government policy changes (i.e. a large funding rate increase through the UFS).

…with actual recapitalisation needs determined by views on future viability…

44. The level of recapitalisation and liquidity provided will ultimately be dependent on how sustainable the ITP network will be going forward. When profitability is low or deficits are being reported, ITPs have less cashflow from operations to fund capital needs and/or rebuild cash balances. If profitability is expected to remain low and/or we consider it will take time for some ITPs to put in place a sustainable business model, then more liquidity should be provided. Achieving desirable levels of liquidity across the entire network is unlikely to be achieved just with Te Pūkenga's financial resources and will likely require further support from the Crown.

45. This will ultimately be dependent on financial performance (including how and when cost reductions are managed), how the ITPs are to be re-established (including any groupings that could occur), whether there would be any shared service subsidiaries (including whether there is retention of some sort of centralised treasury function), capital investment needs, as well as ultimately how well the ITPs perform over the course of 2024 and 2025. Decisions will also need to be made regarding the $45 million of outstanding Crown loans that exist across the sector for Unitec, UCOL, and Otago Polytechnic.

9(2)(f)(iv)

[redacted]

9(2)(f)(iv)

[redacted]

Next steps

48. We would like to discuss the key outcomes of this modelling with you as soon as possible to support the key decisions you are making regarding the vocational education and training system.

49. We will continue to work with Te Pūkenga to refine the modelling and make updates as further information becomes available and decisions are made.

Tim Fowler

Chief Executive

Tertiary Education Commission

01 February 2024

Hon Penny Simmonds

Minister for Tertiary Education and Skills

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