Tertiary Education Commission
Te Amorangi Mātauranga Matua

Aide-Memoire: Financial overview of the tertiary sector

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 a detailed financial overview of the tertiary education sector following our briefing to the incoming minister. It outlines how the system is funded; the key drivers of tertiary education organisation (TEO) financial performance; and where we consider the greatest risks lie. It is intended to assist initial discussions with you about the financial pressures on the system, and both the short- and medium-term options you may wish to consider to support the sustainability of tertiary education and training. We will brief you at a later date on the educational performance of the sector.

2. While this paper covers the entire tertiary education sector, we predominantly focus on tertiary education institutions (TEIs) as these are Crown-owned[1] and form New Zealand's *public* tertiary education system. The Tertiary Education Commission (TEC) therefore monitors them more closely and holds richer data about TEI performance than we do for private training establishments (PTEs).

Executive summary

3. Since 2019, the tertiary sector has faced a range of challenges that have impacted on all TEOs. These challenges include: government-controlled revenue sources falling behind inflation; lower international enrolments due to border restrictions; and large changes in domestic demand at some TEOs. This has resulted in worsening financial performance and led to programme closures, widespread staff restructuring, reduced capital expenditure, and a constrained ability to invest strategically. It has had a negative impact on learners and research capability as a whole.

4. While there are issues across all subsectors, the challenges facing the university sector are unprecedented and there remains widespread uncertainty and risk. The highest risk universities are Massey University (Massey) and Victoria University of Wellington (VUW) which are both currently implementing significant staff restructuring and savings programmes. We are monitoring their position closely and would like to engage with you on the current issues, and the approach to managing overall Crown risk, with you at your earliest convenience.

5. You have committed to begin disestablishing Te Pūkenga and restore local decision-making. There are a range of issues and challenges regarding financial viability that will need to be

[1] Excluding Te Wānanga o Raukawa, when the Education (Te Wānanga o Raukawa) Order 2023 comes into effect on 1 January 2024.

considered as part of disestablishing Te Pūkenga given the former institute of technology and polytechnic (ITP) network remains unprofitable. It will require consideration of how a different operating model can be financially sustainable and meet learner, regional, and employer needs. We will also need to understand your views on shared services and what other functions could be centralised, as well as how work-based training can be best supported. While there are different possible structural variations, in our view, any change to the current structure will require additional funding to ensure the financial sustainability of the network. We can provide further advice on these matters following initial engagements with you.

6. The current position of the tertiary sector has highlighted some underlying issues around how TEOs deliver for learners, undertake research, deliver the skills employers need, support economic growth, and improve society. As Minister, you hold several levers relating to the funding and financing of the sector that can drive specific outcomes. The government needs to be clear on the outcomes it wants to achieve through tertiary education which will influence any decisions around funding. This includes the extent it may want to utilise incentives or create an environment that encourages greater economies of scale in programme delivery and/or the level of specialisation and differentiation – both within subsectors and across the entire tertiary system. It also includes decisions on key issues such as the degree to which the overall financial sustainability of the sector should be reliant on international fee income.

7. In addition to these decisions, there are major and persistent funding pressures on the sector that will require your attention. The TEC does not currently have sufficient funding to fund all forecast demand from 2026 onwards while recently increased tuition subsidies for degree level and above delivery are only in place for 2024 and 2025. These current cost pressures exist even before considering the expected level of inflation over 2025 and beyond, or to recover some of the gap that has opened between tuition subsidies and inflation since 2020.

8. The Ministry of Education (the Ministry) has recently provided you with advice on the proposed higher education funding and financing review (METIS-1319471). You will need to decide on whether you wish to proceed with such a review, and if so, what its scope will be.

How is the system funded and what drives financial performance?

We expect TEOs to operate in a financially sustainable manner…

9. It is important that New Zealand has a financially sustainable tertiary education system which supports high-quality teaching, training, and research. The Education and Training Act 2020 (the Act) requires all TEIs to operate in a financially sustainable manner. While there is no agreed definition of financial sustainability, we expect a sustainable TEI will generate sufficient cashflow from operations so that it can fund a sensible capital programme, respond to changing learner and stakeholder needs, and have adequate reserves to mitigate cyclical downturns in enrolments or other external shocks.

10. The responsibility for ensuring financial sustainability lies with the governing council of each TEI. The TEC's role is to monitor the sector closely and advise our Board and you, as Minister, of overall performance and key risks. While PTEs are private businesses, we nevertheless monitor their financial viability to ensure we make responsible investment decisions and to manage risk to New Zealand's overall network of provision.

…with 80 percent of all TEI revenue controlled by the government…

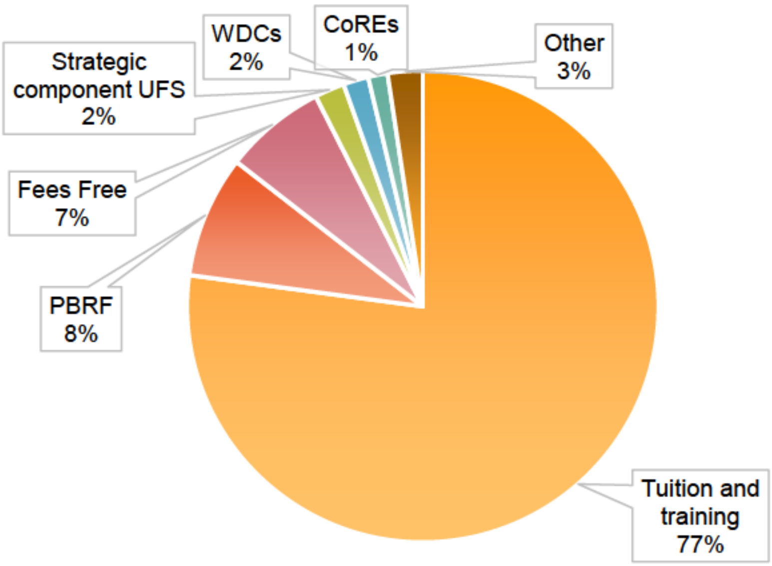
11. The government controls most of the revenue that TEIs receive. Directly, the government decides the amount of government funding for research and educational delivery. Indirectly, the government sets the annual maximum fee movement, which restricts the percentage to which TEOs can increase domestic fees. Decisions made by the government on funding and fee settings significantly influence tertiary sector performance and TEIs' ability to operate in a financially sustainable manner.

12. The government controls around three-quarters of revenue in the university subsector but around 90 percent for Te Pūkenga and the wānanga subsectors. Across the TEC-funded PTE subsector, the proportion varies significantly with some PTEs only receiving a small proportion of their revenue through government funding and others being fully government funded.

…and the TEC allocates nearly $3.8 billion per annum into the tertiary sector…

13. Of the nearly $3.8 billion that the TEC invests in the tertiary sector per annum, $2.9 billion (77 percent) is for volume-based tuition and training (see *Figure 1*). This investment occurs via funds including *Delivery of Qualifications* (formerly the *Student Achievement Component* fund) and *Youth Guarantee* and is intended to subsidise the costs of teaching and learning. TEOs supplement this funding by charging fees to learners, although we provide a further $260 million in funding to cover fees for learners eligible for the Fees Free scheme.

Figure 1: TEC funding breakdown, 2023



14. Around $365 million of TEC's funding is investment in research, including $315 million through the performance-based research fund (PBRF) and $50 million through Centres of Research Excellence (CoREs) funding.

15. We invest over $75 million through the strategic component of the unified funding system (UFS), which supports the vocational system to respond to regional and national skills priorities, assists Te Pūkenga develop a national network of provision, and funds some programme development and maintenance. We provide $65 million in funding to support the operation of Workforce Development Councils (WDCs). The remaining $90 million is invested across a range of funds including support for wānanga, secondary-tertiary interface, and tertiary/industry collaboration projects.

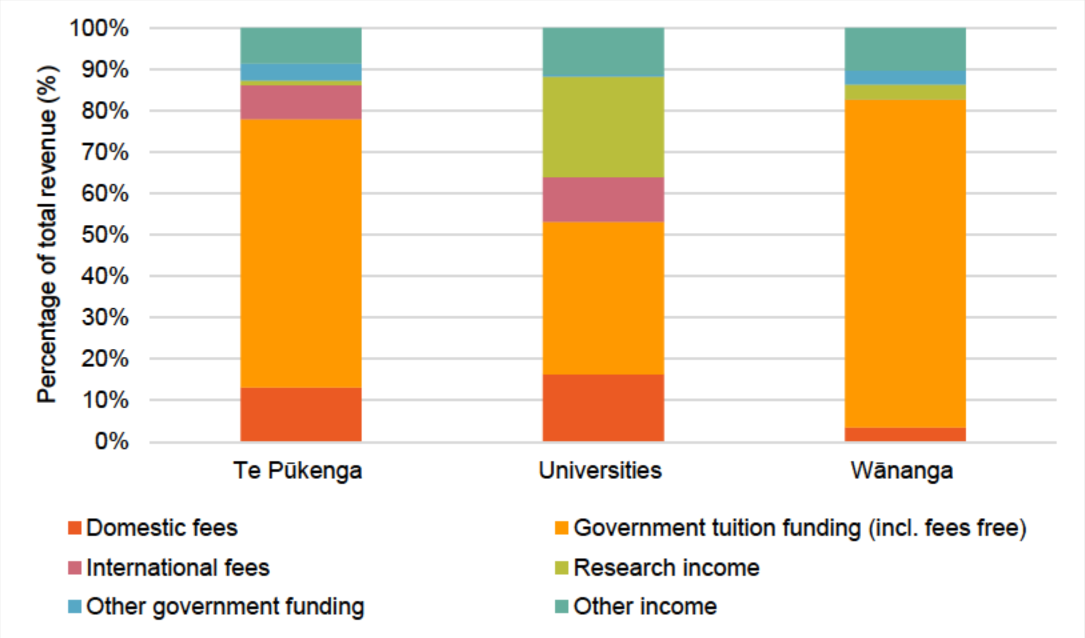
16. The tertiary sector, particularly universities, also receive a range of research funding from agencies other than the TEC. The main sources of research funding are the Marsden Fund, the Health Research Council, and a range of research funds administered by the Ministry of Business, Innovation and Employment (MBIE) such as the Endeavour Fund. In 2023, the university subsector forecast to receive $1.1 billion in research funding, most of which is from government sources (including TEC research funding).

…and Te Pūkenga and wānanga revenue is largely driven by learner enrolments…

17. The revenue model for the wānanga, Te Pūkenga and PTEs is primarily based on tuition, and often tuition with low or no fees. *Figure 2* shows that around 85 percent of total revenue for Te Pūkenga and wānanga relies on learner enrolments (both government funding and tuition

fees). This means for wānanga, Te Pūkenga, and PTEs, when learner numbers decline, profitability can drop sharply, resulting in management having to quickly reduce the organisation's cost base, which can be difficult.

Figure 2: TEI revenue as a percentage of total revenue by source, 2020-2022



18. Conversely, the university model is more diversified across tuition and research activity. Around 65 percent of revenue in the university subsector comes from learner enrolments with one-quarter of revenue being generated by research activity. The remainder comes from 'non-core' activity. Universities' 'non-core' income comes from areas such as accommodation services, commercial revenue, consulting services, and investment returns on trust funds (although the size of these funds differs across universities).

19. The diversity in revenue streams for the university subsector partially helps to mitigate the financial impact of lower enrolments when compared with the rest of the sector (although not when enrolment reductions are more extreme). Universities also offer longer qualifications than other subsectors which provides more stability as learners return over multiple years.

…and there are five primary levers TEOs use to increase revenue…

20. As the government controls the large majority of revenue that TEOs receive, there are five main options TEOs have to increase revenue. These include:

- ***Increase fees by the annual maximum fee movement (AMFM) limit each year:*** TEOs can increase domestic fees by the AMFM limit, which is set by you, annually. Almost all TEOs increase tuition fees by the maximum amount allowable to support revenue growth. It should be noted that work-based fees are not regulated and have no limit.

- ***Increase domestic enrolments***: as TEOs cannot increase fees by more than the AMFM, TEOs often attempt to increase enrolments to increase revenue. This can be achieved through developing new programmes that are attractive to learners and employers, increasing scholarships, improved marketing, and learner success initiatives. These initiatives usually require increased expenditure and can take time to deliver benefits. Other factors outside of the control of TEOs also impact on enrolment numbers. These factors include the number of school leavers, labour market conditions, accommodation offerings and affordability, and competition from other TEOs. Ultimately however, the TEC decides how much volume it will fund for each TEO based on their alignment to agreed strategic priorities and outcomes for learners.

- ***Increase full-fee international enrolments and/or raise international fees***: there are no restrictions on full-fee international enrolment numbers and TEOs can set their international fees at any level. Over the past two decades, various parts of the sector have increased international enrolments to improve or sustain financial performance. While an attractive option, TEOs compete for international learners in a competitive global environment while government policy settings and visa processing performance can impact on overall numbers. TEOs must also balance the potential financial (and wider) benefits from higher international students with the risk of an external event (e.g. COVID-19) causing a sudden downturn in international learners and creating financial risk. As a result, some TEOs put self-imposed limits on international enrolments as well as to ensure a suitable offering (i.e. an appropriate mix of domestic and international students in certain programmes), which limits the potential gains from international fee revenue. Although TEOs can raise international fee levels to increase revenue, setting fees too high can impact on international competitiveness. Most TEOs carefully set fee levels based on their relevant position in the global market.

- ***Increase research revenue***: TEOs that undertake research can seek to increase revenue by attracting additional research funding. Most research funding received by TEOs is controlled by the government which limits the size of the total funding pool available. Nevertheless, TEOs can increase the share of the funding they receive as well as seek research funding from the private sector or from overseas.

- ***Seek to increase non-core revenue***: non-core activity includes sources such as consultancy income, hospitality, childcare, student accommodation, conference income, and donations. This is collectively a bigger revenue source for universities than it is for much of the rest of the sector. While profitable, it can be difficult to increase non-core revenue substantially in the short-term. The university subsector had $933 million invested through trusts at the end of 2022. These funds are typically in balanced investment portfolios and support overall performance but have uncertain returns. Increasing non-core revenue is also a lever used within the PTE subsector.

…although some revenue sources are much more profitable than others…

21. Some of the above revenue sources are more profitable than others, and this differs across subsectors. The core activity of TEIs – education delivery and research activity – is largely break-even or loss-making. Over the past five years, the university subsector has reported an average surplus of $146 million per annum. Around 55 percent of that surplus has come from non-core activity (e.g. student accommodation, hospitality, consultancy), 35 percent from non-operational items (e.g. interest received, net trust income), and only 10 percent from core activity such as teaching and research, despite it representing 86 percent of all income.

22. For Te Pūkenga’s provider-based divisions (and previously the ITP subsector), the average sector deficit has been $52 million per annum over the past five years. This was entirely driven by losses incurred from core teaching and research activity, partially offset by positive contributions from non-core activity and non-operational items.

23. Despite core education and research activity being break-even/loss-making, there is an incentive for TEIs to continue to increase enrolments and research activity to contribute to the large, fixed costs they have. Additional tuition or research revenue helps with achieving economies of scale, and on a marginal basis, additional enrolments can help support profitability.

…with international revenue margins helping to drive a positive contribution from core activity for the university subsector…

24. Full-fee international revenue is a critical source of revenue for universities, Te Pūkenga and PTEs (wānanga only had five international equivalent full-time students (EFTS) in 2022). However, the margins realised on those international enrolments differs significantly between

the two subsectors. Excluding GST, the average full-fee international EFTS in the university subsector paid around $31,500 in 2023 compared to $17,700 for an average full-fee international EFTS at Te Pūkenga.

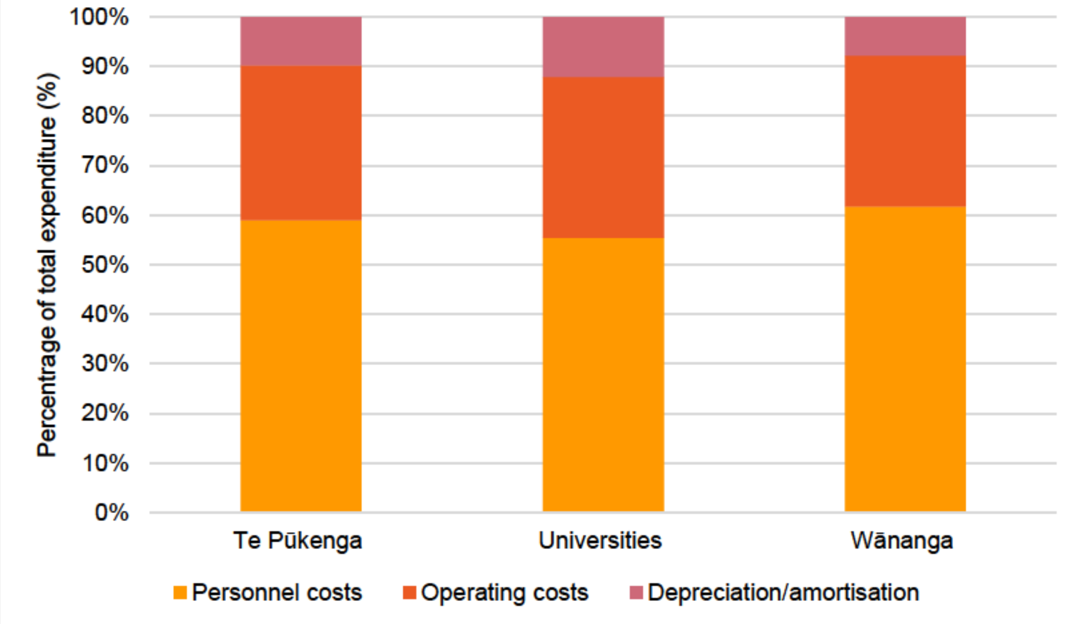
25. The average full-fee international EFTS in the university subsector generates $11,900 more than an average domestic EFTS. This figure is only $2,300 for Te Pūkenga when examining provider-based delivery. For Te Pūkenga, its margin is also more heavily eroded by international agents and their associated fees, which are needed to help secure international enrolments. Agent fees represent 6 percent of university international tuition revenues but 13 percent for Te Pūkenga.

26. The margins realised from international EFTS were a key contributor to the strong performance by universities over the 2010s. Conversely, the fall in international enrolments during COVID-19 has had a significant, negative financial impact. For Te Pūkenga, it has historically realised a similar margin from both domestic and international tuition. The additional revenue from international learners helps Te Pūkenga with economies of scale, but it has not generated the profitability that has been seen in the university subsector. Nevertheless, Te Pūkenga plan on significantly increasing international fee levels in 2024 to help generate a greater margin and support its overall financial position. It is unclear what impact this will have on volume.

…while the majority of expenditure is on staffing costs…

27. Expenditure across all three TEI subsectors is similar with personnel costs being the major cost category (see *Figure 3*). Over 2020 to 2022, personnel costs were 55 percent of overall expenditure for universities, 59 percent for Te Pūkenga, and 62 percent for wānanga. General operating costs were around 30 percent of all expenditure. Depreciation and amortisation costs are slightly higher in the university subsector, at 12 percent of expenditure, because of their larger asset base. This compares to 10 percent for Te Pūkenga and 8 percent for wānanga.

Figure 3: TEI expenditure categories as a percentage of total expenditure, 2020-2022



28. If TEIs have done everything possible to increase revenue, negative shocks can be difficult to manage. TEIs can either respond by cutting spending or by accepting reduced profitability. With TEIs having an operating structure dominated by fixed and semi-fixed costs, it can be difficult to reduce spending if activity levels fall sharply. As personnel costs represent more than half of total expenditure, any major cost saving effort will involve personnel restructuring.

29. For cost cutting exercises to be effective, TEOs need to develop a more efficient operating structure. If efficiencies cannot be found, the savings need to be found by lowering service levels. These reduced services levels directly impact on the learner experience and chance of success. In recent years, high inflation has caused costs to increase more rapidly than constrained revenue increases. This has resulted in lower profitability and led to most parts of the sector cutting back on spending and reducing staffing levels.

…and there are several levers the government has to support financial performance

30. There are currently four key levers available to the government to support the overall financial performance of the tertiary education sector. The Ministry and the TEC will provide you with advice on the use of these levers, typically as part of the annual budget process. These include:

    - ***Increasing tuition subsidy rates:*** around $2.6 billion of the funding that the TEC invests is for *Delivery of Qualifications* or *DQ funding* which has separate funding approaches for Levels 1 and 2, Levels 3 to 7 (non-degree), and Level 7 (degree) and above. TEOs receive funding for the number of domestic EFTS delivered, with the rate of funding per EFTS dependent on the subject area (and mode of delivery for Level 3 to 7 (non-degree) delivery). Increases to tuition subsidy rates are the main mechanism used to increase government funding to the sector. Increases can be made to all rates (to reflect cost pressures) and/or to specific areas (to address viability issues or encourage investment). As outlined in paragraphs 32 and 33, tuition subsidy rate increases have fallen behind inflation since 2020.

    - ***Increasing the volume of delivery that is funded:*** as part of the annual budget cycle, the government must decide the overall amount of funding it will provide for the system. The government makes these decisions based on the Ministry's demand forecasts and fiscal priorities. Over at least the past 10 years, the government has appropriated enough funding to fund all demand.

    - ***Increasing the size of the PBRF pool:*** we currently allocate $315 million annually through the PBRF. Increasing the pool provides further funding to the sector, although 97 percent of all PBRF funding goes to the university subsector.

    - ***Increasing the AMFM:*** as noted earlier, you must set the amount that TEOs can increase domestic fees (excluding work-based fees) through the AMFM. Increasing the AMFM can support overall TEO performance. However, you must balance this with the affordability of study for learners and the flow-on costs to the Crown through the student loan and first-year Fees Free schemes. The Act requires you to consult on any proposed AMFM change.

    - ***Introducing new funds or changing existing funds:*** the government can also decide to introduce new funds for specific purposes or change the funding rules for existing funds.

31. We expect it will be very difficult to secure significant additional funding given fiscal constraints and cost pressures across government.

System funding pressures that require urgent attention

Government funding has fallen behind inflation since 2020…

32. Between December 2019 and September 2023, Consumer Price Index inflation has increased by 20 percent (and is forecast to have increased by 21 percent by the end of 2023). Over that same period:

    - Tuition subsidy rates have increased by 8 percent.

    - AMFM has increased by 8 percent.

- The PBRF pool has remained unchanged at $315 million (it last increased in 2018).

33. Between 2019 and 2023, tuition subsidy rates and AMFM have fallen by 13 percent in real terms while the PBRF has fallen by 21 percent in real terms. As these three revenue sources account for more than half of all TEI revenue, this has contributed to overall revenue increasing by less than expenditure and led to worsening financial performance. If the PBRF and tuition subsidies had kept pace with inflation, we estimate approximately $400 million of additional funding would have been provided to the sector between 2019 and 2023 (excluding any adjustments to AMFM).

34. The previous government committed to increasing tuition subsidy rates by 9 percent in 2024 for Levels 7 (degree) and above and maintaining them at that level in 2025 (meaning they will then decrease by 4 percent in 2026). This increase will close some of the gap for higher education providers to approximately 6 percent (noting the Treasury forecasts inflation to be 2.9 percent in 2024). However, AMFM is set to be 2.8 percent for 2024 and the PBRF will remain unchanged. For all delivery Level 7 (non-degree) and below, tuition subsidy rates will increase by 5 percent in 2024. Despite these increases, per-learner funding will remain significantly below where it was in 2019 in real terms.

35. The impact of a four-year period where funding has increased at a much slower rate than inflation – alongside lower international enrolments and large changes in domestic demand for some TEOs – has contributed to:

    - programme closures;
    - widespread staff restructuring;
    - reduced capital expenditure (including increased deferred maintenance); and
    - a constrained ability to invest in strategic initiatives (including learner support).

36. While some of the recent changes across the sector were needed in response to shifts in learner demand and preferences, the overall financial situation has had a negative outcome on learners and research capability. With the fiscal environment constrained, you will need to come to a view on what outcomes you are seeking from tertiary education and how it is funded to support those views.

…but additional funding is still needed to fund forecast demand

37. The Ministry's August 2023 enrolment demand forecasts show that tertiary sector EFTS are expected to increase by 4.6 percent in 2024 and 1.8 percent in 2025 before falling by 1.9 percent in 2026 and 0.7 percent in 2027.

38. Based on these forecasts, the government will need to increase the appropriation for DQ funding by 9(2)(b)(ii), 9(2)(i) [redacted] in 2025/26 and 9(2)(b)(ii), 9(2)(i) [redacted] in 2026/27 for the TEC to have the ability to fund all of the forecast demand. If no additional funding is provided and assuming the forecast is accurate, we will be unable to fund all delivery, and this is likely to result in us reducing funding in areas of lower priority. This will further impact on the financial performance of TEOs (and potentially the overall viability of some PTEs) and slow down the recovery plans of those currently under financial stress. It could also potentially impact on learners' ability to enrol and complete their studies.

39. Adding to this volume pressure is the time limited 4 percent rate increase approved by the previous government for DQ Level 7 and above funding for 2024 is only to be maintained for 2025 before ceasing. If this rate increase was to be maintained for 2026 and outyears it will require an additional 9(2)(b)(ii), 9(2)(i) [redacted] per calendar year based on the Ministry's demand forecast. If the higher funding rate is not maintained, tertiary providers delivering at degree level and above will experience a per-learner funding cut.

40. These current cost pressures exist even before considering the expected level of inflation over 2025 and beyond, or to recover some of the gap that has opened between tuition subsidies and inflation since 2020. In short, there are major and persistent funding pressures on the sector that will require your attention.

Financial sustainability of the sector

Most parts of the tertiary sector are facing financial issues

41. The tertiary sector has faced several challenges over the past four years. While each subsector and TEO faces its own set of unique circumstances, there have been some overarching causes of the decline in financial performance. These include:

- **Revenue increases being constrained by the Government and not keeping up with inflation.** As noted above, tuition subsidy rates and AMFM have increased well below inflation and the PBRF pool has remained unchanged. Public research funds have also not kept pace with inflation. With the government controlling the majority of TEO income, this has made it very difficult for TEOs to respond to increases in general operating costs, provide staff with pay increases aligned to inflation, and deliver capital projects.
- **Full-fee international revenue has fallen sharply during COVID-19.** With the exception of wānanga, which have almost no full-fee international learners, border closures during COVID-19 had a significant impact on TEO finances due to lower full-fee international enrolments. The impact was significant across universities, Te Pūkenga, and PTEs. While international enrolments are now recovering, it will take time until they return to pre-COVID-19 levels. The forgone revenue over the past four years will have a lasting impact.
- **Domestic enrolments have fallen by more than the sector expected over the past two years.** Domestic EFTS increased by 12 percent in 2021 due to a variety of COVID-19 related reasons such as border restrictions, economic uncertainty, and government initiatives. All subsectors other than the wānanga sector experienced a large rise. At the time, the sector optimistically expected to retain this increased level of domestic learners rather than return to pre-COVID-19 levels. Instead, between August 2021 and August 2023, domestic EFTS have fallen by 8 percent. The failure by TEOs to forecast the decline in domestic enrolments has resulted in many having cost structures and staffing levels that are not aligned with current enrolment volumes. Compounding this issue has been large market share shifts (most noticeably across universities) with some TEOs taking market share from others within the sector, as well as falling retention rates (largely attributed to COVID-19 factors). As a result, some TEOs have experienced unprecedented declines in domestic enrolments over the past two years which has had a large negative impact on revenue.
- **Construction cost inflation has been above general inflation.** This has caused many capital projects to have cost over-runs and planned capital projects to become significantly more expensive. The sector has typically responded by completing the projects that are underway but limiting what new projects are commenced.

42. The above factors, alongside more regional and organisation-specific circumstances, mean many parts of the sector are currently experiencing financial difficulties. This has resulted in deficits being reported by a wide range of TEOs, including liquidity challenges for some. There are several TEIs that we now consider are high risk. In the PTE subsector, we have seen a number of closures and expect these to continue to increase. A more detailed overview of each subsector is provided below with a particular focus on universities and Te Pūkenga.

Financial performance of the university subsector

The university subsector is forecasting an $8 million deficit for 2023…

43. Based on forecasts received by the TEC in September 2023, the university subsector is forecasting a deficit of $8 million (-0.2 percent of revenue) for 2023, which is $26 million worse than budget (see *Table 1*). If achieved, this would be the first time in our records that the overall university subsector has reported a deficit.

44. Within the overall result is a forecast gain of $36 million in net trust income and a $40 million gain in unusual items. Once unusual items and net trust income gains are removed, the subsector is forecasting an underlying deficit of $85 million (-1.8 percent of revenue) with some universities under significant financial stress.

Table 1: Net surplus/deficit, budget versus reforecast for 2023 ($million)

	2023 budget	9(2)(b)(ii)
Auckland	35.1	[redacted]
AUT	6.2	
Lincoln	0.1	
Waikato	-5.0	
UC	-20.2	
Otago	-2.0	
VUW	0.8	
Massey	2.9	
TOTAL	**17.8**	

…with five universities forecasting an underlying deficit…

45. The University of Auckland (Auckland) is forecasting the strongest result for 2023 with a 9(2)(b)(ii) [redacted] underlying surplus. Within this forecast, Auckland has not assumed any net trust income, which based on earlier forecasts should be around 9(2)(b)(ii) [redacted] This would take Auckland's result closer to a 9(2)(b)(ii) [redacted] surplus.

46. Lincoln University (Lincoln) and Auckland University of Technology (AUT) are also forecasting underlying surpluses with all five other universities forecasting an underlying deficit – ranging between 3 percent of revenue at 9(2)(b)(ii) [redacted] to 11 percent of revenue at 9(2)(b)(ii) [redacted] VUW is forecasting an underlying deficit of 9(2)(b)(ii) [redacted] of revenue but is expecting to report an overall surplus as a result of a $41 million earthquake-related insurance settlement.

47. UC is forecasting the fourth largest deficit but remains in a strong financial position with a positive enrolment outlook and significant cash balances on hand. Its deficit is being driven by investment in a range of strategic initiatives (e.g. student success, digital transformation, its digital and screen campus, and a new graduate school) which are expected to deliver a positive return in future years.

48. The three universities with the largest deficits – Otago, VUW, Massey – are all currently implementing a range of savings and recovery initiatives.

…due to a decline in domestic enrolments and higher than budgeted expenditure…

49. The key drivers of the worse than budgeted performance in 2023 are lower domestic enrolments – which have declined by 4 percent when a 2 percent increase was expected and

higher than budgeted expenditure. Expenditure is forecast to rise by 9 percent in 2023 compared to a 6 percent budgeted increase. This mainly reflects the high inflationary environment, although there is also an element of optimistic budgeting and universities failing to achieve planned personnel and operating savings in 2023 (e.g. Massey).

…and some universities need to make major changes to become financially sustainable…

50. In response to the financial challenges over the past three years, university Councils have had to take action to improve financial sustainability. These actions have included staff restructuring, seeking operating savings and efficiencies, deferring or cancelling capital projects, and selling surplus non-strategic assets. While the impact of these challenges has been sector-wide, some universities are currently under greater pressure than others with larger savings needing to be found. This is partly due to external factors, but it is also a reflection on how well universities have responded over the past three years. This is clearly seen through different approaches to staffing levels.

51. Lincoln and Auckland made significant reductions in staffing levels over 2020 and 2021, when COVID-19 first hit, due to a forecast decline in international enrolments, while Waikato has taken a rolling approach to restructuring over the past three years. As a result, between 2019 and 2022, these three universities improved their total EFTS to total staff ratios from a financial perspective (i.e. more learners for each staff member) and are benefiting from these ongoing savings. Otago, UC, AUT, Massey, and VUW on the other hand have reported a decline in their total EFTS to total staff ratios (i.e. fewer learners for each staff member). Consequently, except for UC, these four universities have needed to implement widespread staff restructuring recently to ensure their staffing levels are aligned to enrolments levels, both now and in the future.

…with widespread restructuring announced over the past year…

52. AUT implemented significant staff restructuring over 2022 and early 2023 to support its medium-term sustainability. While management was seeking a slightly higher reduction than what was achieved (due to legal process issues) overall staffing levels were still reduced by 164 full-time employees (FTEs) – equivalent to around 7 percent of total staff. 9(2)(b)(ii) [redacted]

53. The latest information available to the TEC on staff restructuring plans for Otago, VUW, and Massey is summarised below:

- ***VUW*** has reduced staffing levels by 194 FTEs (7 percent of total staff) through its change processes in 2023. 9(2)(b)(ii) [redacted] Around one-third of the reduction was in academic positions, with the remainder in non-academic positions. Academic programmes that had low enrolments and/or sustainability issues were targeted.

- ***Otago*** is seeking to reduce staffing levels by 9(2)(b)(ii) [redacted] A 107 FTE reduction was achieved through voluntary redundancies with the remainder to be attained through rolling change proposals over 2023 and early 2024. The total staff reduction achieved will depend on where savings are made, and there remains uncertainty on the overall FTE change. 9(2)(b)(ii) [redacted] Reductions are being targeted in programmes which have low enrolments.

- ***Massey*** made a net reduction of 34 FTEs in early 2023 as part of its professional services review that commenced in 2021. In July 2023, Massey called for voluntary redundancies in 245 positions, in areas with low enrolments and as part of its Digital Plus transformation which aims to consolidate programmes onto one campus (and online) wherever possible to limit duplication of teaching facilities and resources. In September

2023, Massey noted that it had accepted 89 voluntary redundancies. The remaining reductions will be sought through formal change proposals. Management has not indicated a specific target, 9(2)(b)(ii) [redacted]

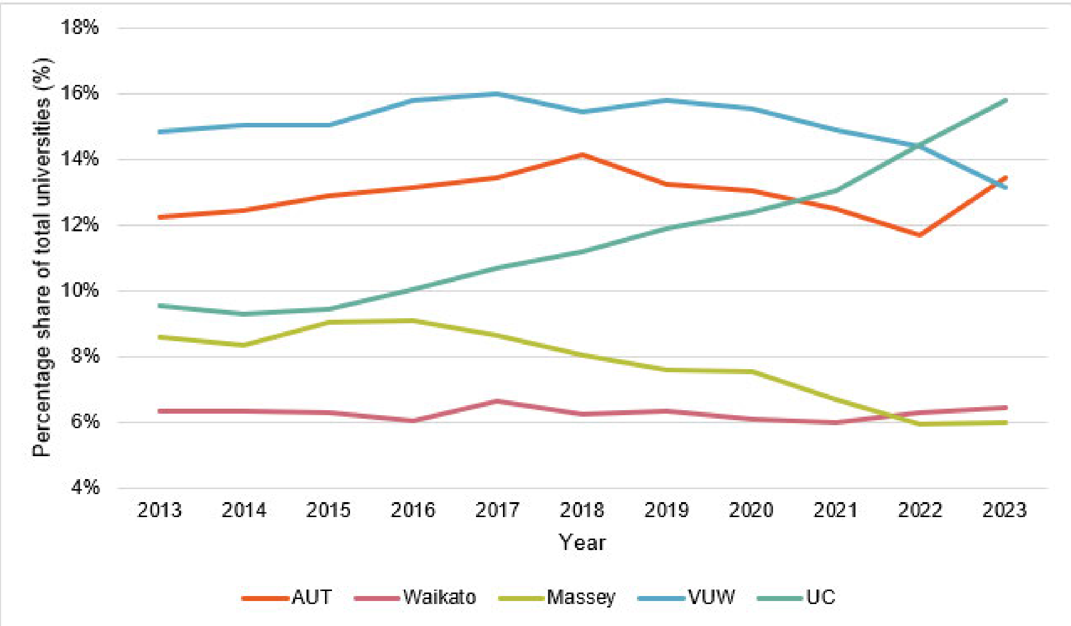
54. Based on forecasts from early 2023, the university subsector is forecasting total FTEs to reduce 9(2)(b)(ii) [redacted] between 2019 and 2024. Around 55 percent of the decline is expected to be in non-academic roles (with the remainder in academic and research only roles). However, the increase in tuition subsidies for 2024 and confirmation of a faster than expected recovery in international EFTS may moderate this decline.

…however, universities need to continue to assess their strategic direction…

55. The impacts of COVID-19 have forced universities to examine some of the fundamental ways they operate. While there has been a need to reduce expenditure, universities have also needed to review their strategic plan and priorities. This includes reviewing how learner wellbeing and success is supported, delivery and operating models, programme offerings, capital programmes and space utilisation, accommodation offerings, and how they deliver for their communities. Our engagements with universities have highlighted that changing learner expectations and aspirations as well as economic pressures are driving a need for change in how they operate.

56. The current financial situation of some universities has been partly driven by how well councils and management have responded to this need for change, with some universities responding better than others. This is evidenced by the significant divergence in the attractiveness of some universities to domestic learners pre- and post-COVID-19. For example, VUW and Massey have both lost significant market-share from the school leaver market over this period while UC has made significant gains (see *Figure 4* for changes in market share for selected universities). For VUW and Massey to turn around their performance, management will need to identify and understand why other universities are growing at their expense and what can be done to regain market share.

Figure 4: Market share of 18-year-old learners for selected universities



57. From our engagements to date, there does not appear to be any obvious factors or initiatives being implemented by VUW and Massey that, in our view, would allow them to regain market

share from other universities in coming years. There remains a substantial risk that domestic enrolments fall further across these two institutions in 2024 and 2025. The significant changes in enrolments seen over the past two years reinforces the need for all universities to regularly review their programme offerings and demonstrate value to learners, employers, and communities.

…with the sector expecting another deficit in 2024…

58. Based on forecasts received in September 2023, the university subsector is forecasting a deficit 9(2)(b)(ii) [redacted] The overall forecasts are likely to change slightly as universities finalise their budgets.

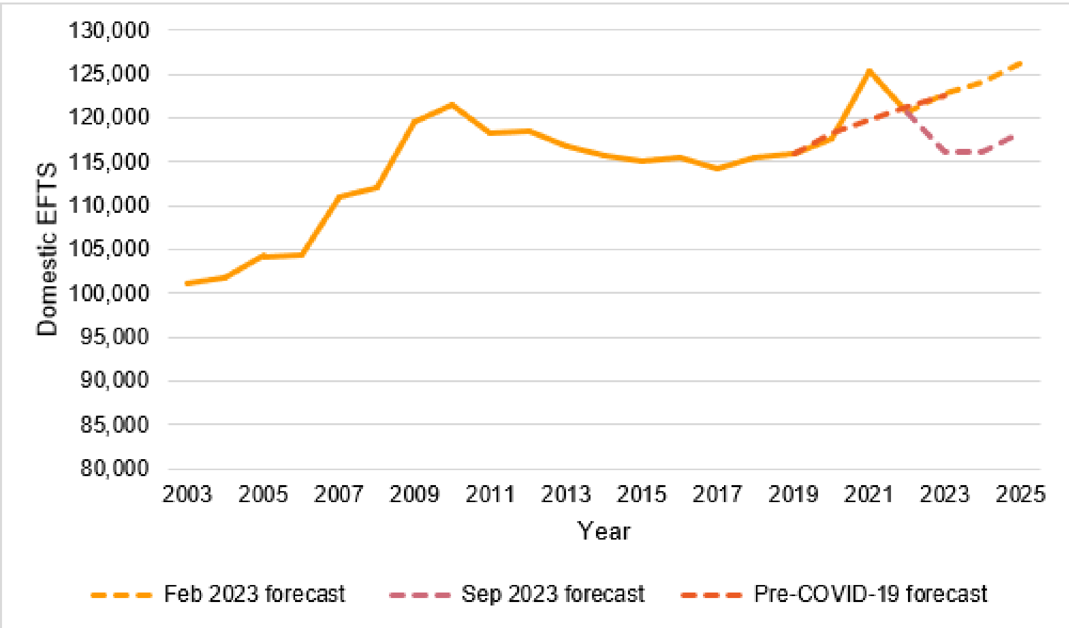
…before returning to surplus position in 2025…

59. The subsector is then forecasting a 9(2)(b)(ii) [redacted] This recovery is based on a combination of revenue increasing on the back of a rise in both domestic and international enrolments and efficiencies gained from restructuring efforts. Typically, there has been an optimism bias in university forecasts although we consider there are both upside and downside risks to current forecasts.

…despite domestic enrolments forecast to be lower than previously expected…

60. The university subsector is forecasting domestic enrolments to remain flat in 2024 (in line with the Ministry's demand forecast of a 0.3 percent increase for universities). Nearly all universities are forecasting domestic enrolments to be relatively flat, with the exception of UC 9(2)(b)(ii) [redacted]

Figure 5: Forecast domestic EFTS, university subsector

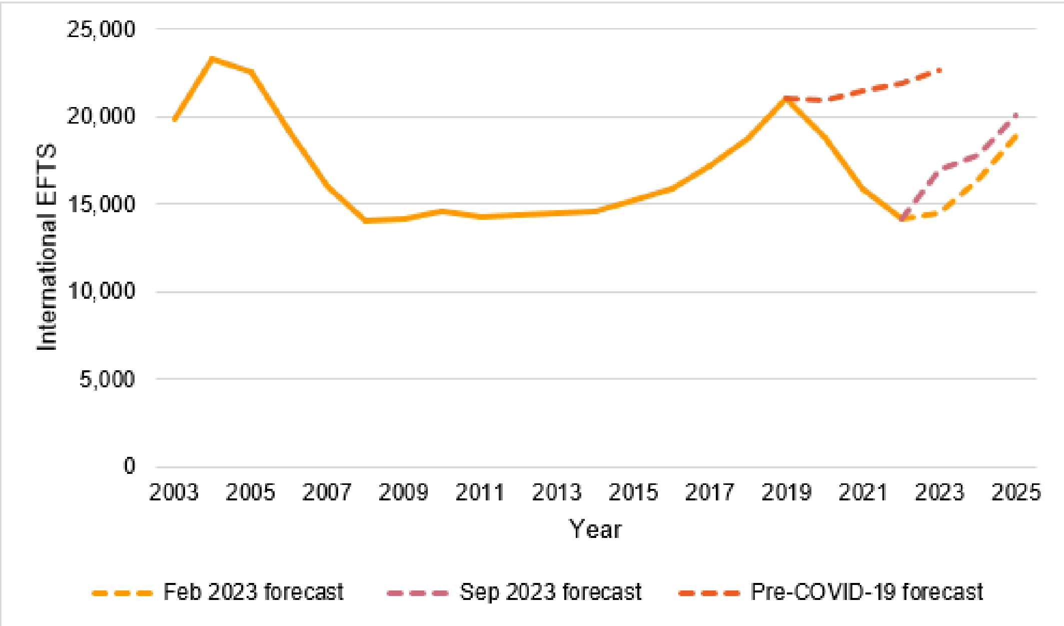


61. In total, over the 2023 to 2025 period, the university subsector now expects to deliver 22,500 fewer domestic EFTS than it had forecast at the beginning of the year. This equates to around $450 million in less revenue than expected over this three-year period (partly driven by optimistic forecasts) and has been a key driver of why some universities have had to make large reductions in expenditure. 9(2)(b)(ii) [redacted] *Figure 5* also shows that domestic enrolment growth is now expected to be well below pre-COVID-19 expectations (while noting that the sector has historically over estimated domestic enrolment growth).

…while international enrolments are expected to continue to recover strongly…

62. The university subsector significantly outperformed its 2023 forecasts for full-fee international enrolments and is now expecting to deliver nearly 17,000 full-fee international EFTS in 2023 – 17 percent above the forecast at the beginning of the year. The sector then expects growth of 5 percent (approximately 800 EFTS) in 2024 and 13 percent (approximately 2,300 EFTS) in 2025 (see *Figure 6*). These forecasts largely align to those provided to us in February 2023 and we consider there is potential upside given the strong growth reported this year.

Figure 6: Forecast full-fee international EFTS, university subsector



63. Over the two years to 2025, 9(2)(b)(ii) [redacted] all forecast full-fee international enrolments to increase by more than 30 percent. Nevertheless, by 2025, full-fee international EFTS are still expected to be 5 percent lower than their 2019 levels with only two universities –9(2)(b)(ii) [redacted] – expecting to be above their pre-COVID-19 levels. 9(2)(b)(ii) [redacted] each expect to be around 20 percent below pre-COVID-19 levels in 2025. However, due to universities increasing international tuition fees, full-fee international fee revenue at a sector level is expected to exceed 2019 levels in 2024.

…but the subsector is facing a range of financial risks…

64. The university subsector is currently going through a period of significant change and there remains considerable uncertainty and risk. There is also less reliability around forecasts which contributes to increased risk. We consider there are six key financial risks currently facing the subsector:

- ***Domestic enrolments may continue to fall.*** Domestic EFTS have fallen by 8 percent over the past two years in the university subsector and have now returned to their pre-COVID-19 levels. It remains unclear whether this downward trend will continue or stabilise and there is a risk that enrolments fall further in 2024. The strong labour market, fewer students gaining University Entrance, changing social trends and study location preferences, lower retention rates, and the increased cost of living will all potentially have a negative impact on domestic enrolment numbers. For some universities – particularly VUW and Massey – there is a strong chance that they continue to lose domestic market share after declines in recent years. Lower domestic enrolments will require further cost saving initiatives to be implemented, including potentially further staff restructuring and adjusting the size of their underlying asset base. Fundamentally, these universities will need to form a realistic and strategic view on their future size and scale and work hard to implement initiatives that ensure they deliver that vision.

- ***Savings plans and constrained expenditure forecasts are not achieved.*** Universities are collectively forecasting expenditure to increase by only 6 percent over the next two years. This follows a forecast increase of 9 percent for 2023. With inflation remaining high, there is a risk that expenditure will be higher than forecast leading to larger deficits. Part of the driver of the low expenditure forecasts is the assumption of significant savings plans being achieved, some of which the TEC considers are optimistic with regards to both timing and size (given recent failures to meet savings targets to date in some universities). Higher than forecast expenditure will require further cost savings initiatives to be implemented and put pressure on liquidity with a reduction in cash balances or increasing debt balances.

- ***Extensive capital requirements are unable to be funded***. During COVID-19, the university reduced capital expenditure to preserve cash. With construction cost inflation remaining high and many universities experiencing reduced profitability (lowering cashflow), there is a risk that universities will be unable to fund all their capital requirements which has several flow-on risks to their capital assets. Universities are now forecasting to undertake [redacted] 9(2)(b)(ii) of capital expenditure in 2024, when at the beginning of 2023 they had been forecasting to undertake [redacted] 9(2)(b)(ii). With lower planned capital expenditure, there is a risk that some universities will not be able to use certain assets (e.g. due to seismic or compliance issues) and/or they are unable to offer facilities that meet students' needs (or that are comparable to other universities), which risks reducing their attractiveness to both domestic and international learners and has flow on revenue impacts. There is also a risk that an urgent capital expenditure items arises that they are unable to fund. This will put pressure on cash reserves and debt balances or in extreme cases, could require the Crown to consider additional financial support.

- ***Some universities may experience a liquidity crisis***. Several universities are reporting large underlying deficits in 2023 and are forecasting liquidity to be tight over the coming years whilst still needing to deliver significant improvement to their underlying profitability. If performance is worse than expected and they are unable to realise benefits from current initiatives, or there is an urgent demand on cash, there is a risk that some universities may run out of cash and/or breach borrowing limits. [redacted] 9(2)(b)(ii), 9(2)(i). Even if a liquidity crisis is avoided, some universities are forecasting high debt levels for an extended period with limited means to repay debt balances, leaving them vulnerable to a negative financial shock and restricting future investment options. Careful monitoring of cash and debt levels will be required by university management.

- ***Universities' ability to pivot to changes in the operating environment.*** After a long period of stability, COVID-19 and other recent events have created an uncertain operating environment which has required significant responses from university management. Factors such as increased interest rates, high inflation, cost of living challenges, changes to study and work habits (more remote working) and changes in delivery models (e.g. more online and flexible delivery) have had a considerable impact on university operations, student preferences, and competition. This has increased financial risk and there is a greater need for management to evaluate and respond decisively to these changes, including assessing whether adjustments are needed to the university's strategic direction and associated capital investments. The successful navigation of these issues is necessary to ensure financial sustainability.

…and universities will need to carefully monitor and mitigate risks as they arise…

65. All universities will need to carefully monitor and manage risks over coming years. This will require university management to ensure they are regularly updating forecasts, undertaking scenario analyses, and putting clear plans in place to manage downside scenarios, should they occur. University Councils will need to ensure high quality reporting and information is being provided from management, and that risks are being appropriately monitored and managed. Given the current challenges are unprecedented in recent times, this will require Councils and management to potentially change the way they operate. For some, we expect that this will impact on their long-term strategic plans, which could alter the direction of the university over the next 10 to 15 years.

66. While financial risks will need to be carefully managed, universities will also need to carefully monitor the impact that reducing services or programme delivery will have on their overall performance and their ability to invest in strategic initiatives to ensure high-quality educational delivery. This will require the careful balancing of priorities by management and Councils. We will be closely monitoring this issue through our engagements. We are also actively monitoring where capability and provision may be lost or reduced across the network.

…and we consider two universities are high risk…

67. In *Appendix One* we have assessed each university against five key metrics – short-term profitability, medium-term sustainability, total enrolments, access to cash, and management capability – and provided an overall risk rating. These assessments are subjective and there is an element of relativity in the assessments given the current environment (i.e. a break-even result in the current environment may be considered low risk whereas prior to COVID-19 it was considered high risk).

68. Based on our assessments, both VUW and Massey are considered high risk, and Otago, Lincoln and Waikato are considered medium risk.

…and there are several levers the TEC or the Minister could utilise to manage risk

69. In response to increased risk across the university sector, there are several levers that can be used to monitor and mitigate risks. In general, we use a graduated approach to manage increases in risk and utilise both legislative and non-legislative levers.

70. While the TEC is the monitoring entity that prepares advice on these levers, depending on the lever to be used, the decision-maker could be the Chief Executive of the TEC, the Secretary for Education, or the Minister. Key levers that can be utilised include:

- increased reporting.
- increased engagement.
- appointing an independent financial advisor (by agreement).
- appointing a Crown observer under the Act.
- dissolving the Council and appointing a commissioner.

71. The first three levers are implemented by the TEC, while the latter two levers are implemented by you as Minister. Multiple levers can be used at one time.

72. Across the university subsector we already have increased reporting and engagement in place with several universities (e.g. receipt of finance committee papers, regular financial and enrolment information). 9(2)(b)(ii), 9(2)(i) [redacted]

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

[redacted] [redacted]

Financial performance of Te Pūkenga

74. We will provide you a separate paper on Te Pūkenga's overall performance in coming weeks (AM-23-00901 refers). The below focusses only on Te Pūkenga's financial performance. While you have committed to begin disestablishing Te Pūkenga and restore local decision making, the below analysis is based on Te Pūkenga continuing along its current path.

Te Pūkenga reported an $80 million deficit in 2022…

75. Te Pūkenga reported an $80 million deficit (-6.3 percent of revenue) in 2022, which was $22 million worse than budget. The key driver of the worse than budget result was lower domestic provider-based enrolments, which fell by 9 percent (or 5,210 EFTS) in 2022, when growth had been budgeted for. Partially offsetting the decline in provider-based EFTS was growth in work-based enrolments.

76. The $80 million group deficit was comprised of a $119 million deficit for the provider-based divisions (former ITPs) and a $14 million deficit for head office, partially offset by a $53 million surplus for the work-based divisions.

…and is forecasting a $93 million deficit for 2023…

77. Based on forecasts provided in September 2023, Te Pūkenga is now forecasting a $93 million deficit (-7.1 percent of revenue) for 2023. If achieved, this would be $66 million worse than its budgeted group deficit of $27 million. Total revenue is expected to be $124 million (or 9 percent) lower than budget. Partially offsetting the decline in revenue is lower expenditure, which is expected to be $51 million (or 4 percent) below budget.

78. The provider-based divisions are forecast to report a $185 million deficit in 2023 with all divisions forecasting deficits. The work-based division is forecast to report a $101 million surplus. These forecasts reinforce the challenge Te Pūkenga has in dealing with highly unprofitable on-campus delivery and profitable work-based delivery and the need to build an integrated infrastructure, operating model, and delivery approach to support a financially sustainable model across the country. These challenges have existed since the formation of Te Pūkenga but have been heightened by the wider challenges facing the sector, and the introduction of the UFS which has lower funding rates for on-campus delivery and higher funding rates for work-based delivery compared to the previous funding system.

…with lower enrolments and the Crown loan driving lower revenue…

79. A key driver of the lower revenue forecast is domestic enrolments falling sharply. Te Pūkenga budgeted for a 1 percent increase in provider-based EFTS and a 3 percent increase in work-based enrolments. Te Pūkenga is now forecasting that total domestic enrolments will be 10 percent lower than budget in 2023. On-campus domestic EFTS are forecast to be 9 percent below budget while online and work-based enrolments are both forecast to be 12 percent below budget. Partially offsetting the decline in domestic enrolments has been a 71 percent increase in international enrolments. Te Pūkenga is forecasting full-fee revenue to be $21 million higher than budget (totalling $88 million).

80. The other contributing factor to the increased deficit is the impact of the Crown loan. For 2023, the change to an interest free loan results in a $58 million reduction in revenue as Te Pūkenga had budgeted it would receive $58 million in Crown operating funding (rather than a loan) to fund its digital transformation.

…with Te Pūkenga needing to reduce expenditure to support financial sustainability…

81. Te Pūkenga inherited a financially troubled ITP subsector and many of the underlying changes required to move Te Pūkenga towards financial sustainability are yet to occur. The fundamental need for change has been intensified by the fall in domestic enrolments over the past two years, as well as the impact of border restrictions on international enrolments. To date, progress has been slow in implementing actions that move the organisation towards financial sustainability. While vacancy management, recruitment freezes, and expenditure control has mitigated some of the reduction in revenue – the larger transformational changes required for Te Pūkenga to be sustainable going forward are yet to occur. The gradual move to the new organisation design, including those changes made over September 2023, have not been sufficient.

82. Although Te Pūkenga has now put in place a finance strategy and financial plan to move towards sustainability, we consider there remains several key areas where further work is required. Until there is greater clarity and detail, there remains considerable uncertainty around the achievability of Te Pūkenga's forecasts and its ability to deliver long-term financial sustainability. In particular, Te Pūkenga has yet to come to a view on the optimum size and scale of the organisation going forward.

83. The integration of delivery roles and how work-based, campus-based, and online delivery will be integrated is expected to occur in 2024 and beyond. If Te Pūkenga is to achieve financial sustainability under current settings, it will need to change its labour model given around 80 percent of Te Pūkenga's workforce is on the provider-based side. This area continues to be unprofitable due to continued declines in domestic provider-based enrolments over the past ten years (alongside recent funding changes). While achieving financial sustainability was always going to take time, Te Pūkenga's current financial position is at least partly due to its inability to achieve meaningful strategic integration gains (in both infrastructure and staffing models) over its first three and a half years of operation.

84. Te Pūkenga's ability to achieve savings and efficiencies is limited to an extent by the continued need to operate multiple legacy business systems. Further changes (and ultimately staff reductions) are expected to occur as core systems are replaced and digital transformation is undertaken over the next four years – supported by the Crown's $220 million interest-free loan announced through Budget 2023.

…and Te Pūkenga is now forecasting a return to surplus in 2027…

85. Over the past six months, Te Pūkenga has amended its transformation programme to reduce the overall cost. However, with the previous government deciding to fund Te Pūkenga's digital transformation via a Crown loan rather than an operating grant, and an uncertain domestic enrolment environment, Te Pūkenga is now forecasting larger ongoing deficits for the medium-term.

86. Based on forecasts undertaken in June 2023 (the last long-term forecasts available), Te Pūkenga is forecasting a collective deficit 9(2)(b)(ii) [redacted]

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

87. 9(2)(b)(ii) [redacted]

88. 9(2)(b)(ii) [redacted]

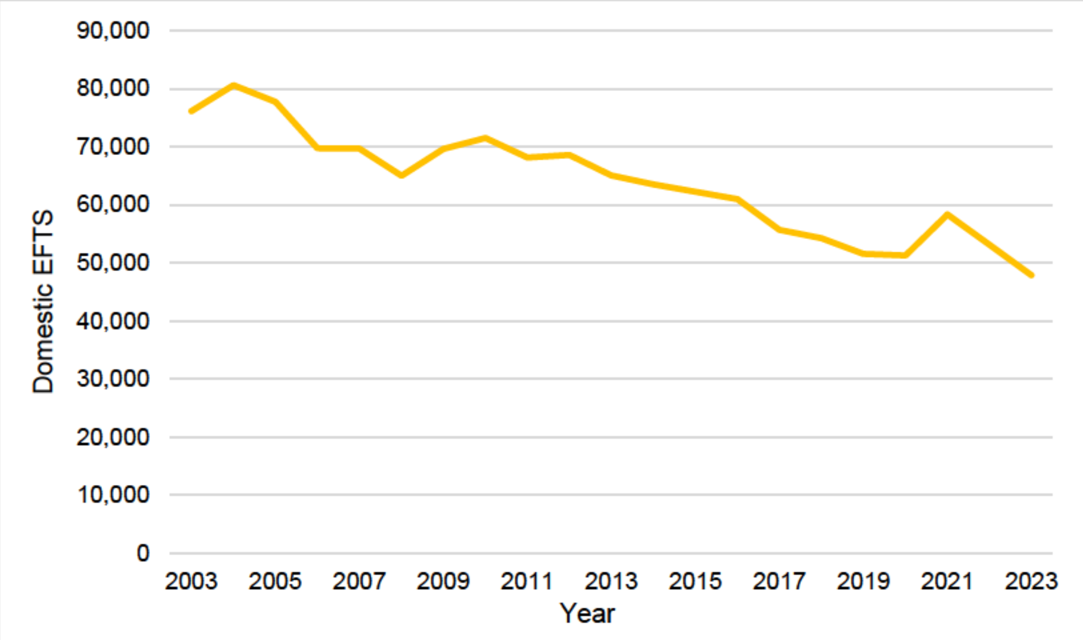
…with net cash expected to remain positive over the forecast period…

89. Despite the forecast deficits, Te Pūkenga is forecasting net cash (cash minus debt) to fall from 9(2)(b)(ii) [redacted] This includes Te Pūkenga fully drawing down the $220 million Crown loan. If performance is not as strong as forecast, Te Pūkenga cash balances would decline, and it would need to begin taking on commercial borrowings and/or implement additional cost saving responses to ensure it has sufficient liquidity.

…and the biggest risks are around domestic enrolment growth and expenditure forecasts being missed…

90. Although we consider Te Pūkenga's international enrolment forecasts are sensible (and indeed there is potential upside to the forecasts), a key risk to the recovery is that domestic enrolment forecasts (which are expected to average around 1 percent growth per annum between 2025 to 2032) are not achieved given the strong labour market and the downward trend in provider-based domestic enrolments over the past ten years (see *Figure 8*).

Figure 8: Domestic funded provider-based EFTS in ITP sector



91. If Te Pūkenga continues along its current path, there is also a strong risk that the sought cost savings (including through the new organisation design) will not be sufficient or that the digital transformation costs more than forecast. If these risks eventuated, further efficiencies would need to be found and/or key parts of the transformation deferred. If long-term performance is not as strong as forecast, then Te Pūkenga would potentially have liquidity issues in future and/or have difficulty repaying the Crown loan.

92. Te Pūkenga is implementing a complex and highly interdependent work programme, and it was always expected to take time to deliver the benefits and move towards financial sustainability. In any large multi-year transformation programme such as this, issues will arise, costs will change, and adjustments will need to be made. Furthermore, Te Pūkenga is implementing this transformation while underlying operations remain unprofitable. Strong and decisive governance will be required to be able to manage these challenges.

…while disestablishing Te Pūkenga will also come with financial sustainability challenges

93. You have committed to begin disestablishing Te Pūkenga and restore local decision-making. Further engagement with you is required to fully understand your plans for Te Pūkenga, and the vocational education and training system more broadly, and how the changes could be implemented and funded. There are a range of issues and challenges regarding financial viability that will need to be considered.

94. As noted earlier, the former ITP network is forecasting a $185 million deficit (-20 percent of revenue) in 2023 with all former ITPs forecasting deficits. Even under the previous funding system (i.e., prior to the implementation of the UFS), the former ITP network reported a deficit of $119 million in 2022 and domestic enrolments have fallen further in 2023.

95. Any disestablishment of Te Pūkenga will require consideration of how a different operating model can not only be viable and a going concern on establishment, but financially sustainable over the medium-term, and generate sufficient profits to be able to fund a sensible capital plan and meet learner, regional, and employer needs. Related to this, we will need to understand your views on shared services and what other functions could be centralised, as well as how work-based training can be best supported.

96. While there are different possible structural variations, in our view, any change to the current structure will require additional funding to ensure the financial sustainability of the network. We can provide further advice on these matters following initial engagements with you.

Financial performance of Wānanga

Wānanga performed well over the past three years but two have budgeted for deficits in 2023…

97. All three wānanga navigated the COVID-19 period relatively well, with strong sector surpluses reported over 2020, 2021 and 2022. Wānanga have almost no full-fee international learners, so were not directly impacted by border closures (although lockdowns had a greater impact on domestic enrolments for some wānanga when compared with other providers, due to their greater reliance on face-to-face learning, and utilisation of marae as delivery sites). Furthermore, wānanga have benefited from other non-tuition payments from the government related to Waitangi Tribunal claims and a recognition of historic underfunding of the wānanga.

98. Despite this performance, wānanga have also faced increased financial pressure in recent years due to lower domestic enrolments, higher costs, increased competition for Te Reo provision, and their commitment to provide a significant proportion of provision with zero fees for learners. Wānanga have a high reliance on tuition funding from the TEC, meaning tuition subsidy increases falling well behind inflation has a particularly negative impact. Higher interest rates are however providing some benefits given their substantial cash balances.

99. In 2023, both Te Wānanga o Aotearoa (TWOA) and Te Whare Wānanga o Awanuiārangi (Awanuiārangi) budgeted for deficits of $3 million (-1.8 percent of revenue) and $0.4 million (-1.0 percent of revenue) respectively. Te Wānanga o Raukawa (Raukawa) budgeted for a $3 million surplus (10 percent of revenue).

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

[redacted]

…but all three have strong cash balances…

101. Despite two out of three wānanga budgeting for a deficit in 2023, all three wānanga have strong balance sheets and maintain large cash reserves and liquid investments. As such, we do not consider any of the wānanga pose a short-term financial viability risk. Nevertheless, there are some longer-term financial sustainability concerns for TWOA given the forecast deficits.

…and there is work underway address longstanding concerns of the wānanga subsector

102. In recognition that approaches to improving policy settings for wānanga had typically been issues-based and reactive, including in response to Waitangi Tribunal claims, in 2018, the former Minister and Associate Minister of Education directed the Ministry to engage in in an open dialogue with wānanga leaders to discuss reforming the Crown's relationship with the subsector. Since August 2019, there has been an enhanced work programme between officials and the wānanga subsector, called Te Hono Wānanga, to consider wānanga concerns more holistically. Te Hono includes workstreams on legislation; funding; quality assurance; and mātauranga Māori. The Ministry will brief you further on Te Hono Wānanga.

103. On 1 January 2024, Raukawa will become a Category B wānanga. It will no longer be a Crown entity and it will be accountable to its founding iwi. TWOA and Awanuiārangi are still considering their future under the new legislative framework.

Financial performance of private training establishments

The PTE subsector is a diverse group…

104. The PTE subsector is not a homogenous group. PTEs vary greatly in terms of size, educational focus, organisational capability and financial performance. They also operate under a variety of ownership models. As such, PTEs vary from large international owned corporates to small locally based charities. PTEs may also be a small division in a large non-tertiary operation, while several new PTEs emerged to take on work-based learning previously delivered by industry training organisations.

105. While most TEC-funded PTEs are relatively small, the largest PTE group (Up Education) is bigger than the smallest wānanga (by EFTS). Other than for the very few large PTEs, most individual PTEs tend to be much smaller than other providers, and narrowly focussed on a specific industry or area such as hairdressing or tourism and management.

106. In 2022, there were 385 registered PTEs of which 230 received TEC funding. The PTE subsector receives around 13 percent of TEC's total funding. Of the 230 TEC-funded PTEs, 71 percent were funded to deliver fewer than 100 EFTS of formal tuition.

…and an increasing number of PTEs are facing financial difficulties…

107. The TEC-funded PTE subsector initially managed well during COVID-19, with the support of the government's broader economic support packages and the government's decision not to recover under-delivery in 2020. However, the subsector has since come under increasing pressure, experiencing many of the same challenges faced by other TEOs – declining domestic demand, low international enrolments, and increased costs. Some PTEs have been particularly impacted in 2023 by lower funding rates (e.g. for online delivery) arising from the implementation of the UFS, as well as immigration system settings (where they also deliver to international students).

108. While some PTEs have been able to pivot their delivery and adjust their cost base over recent years, others have been slow to respond. We currently assess 48 PTEs as high risk and 53 as medium risk in terms of financial viability. One of the largest risks is how quickly small to medium-size PTEs can swing from low/medium risk to high risk, when they experience a shift in student demand and do not have large financial reserves to call upon. However, we have no significant financial viability concerns about the four largest PTE groups (which account for nearly one-third of funding for the PTE sector).

109. Since 2021, 16 TEC funded PTEs have closed, with a further two that are still operating but no longer receiving TEC funding. However, without learner demand, the TEC has extremely limited ability to fund organisations in order to keep them in the network and we consider it likely that PTE closures will continue to increase over the next two years.

…and we are working to support PTEs, protect learners, and manage any risks to the network of provision

110. PTEs form an important part of the overall network of provision across New Zealand. The PTE subsector is flexible enough to respond quickly to market forces and, while some PTEs may not remain viable through the current challenges, other PTEs are financially sound and will be able to respond to opportunities to fill any gaps in provision.

111. We are actively monitoring PTEs that are under financial pressure and engaging with them to understand how they might respond. We provide support and guidance, while also ensuring that learners are not disadvantaged and that where closures occur, learners can transfer to alternative providers to complete their education and training as seamlessly as possible. While we expect closures to increase over the short term, there remains a steady flow of new PTEs entering the market and applying for TEC funding.

Future sustainability of the sector and next steps

112. The tertiary education sector is facing its biggest financial challenge in a generation, and it is being felt across all subsectors. While some of the current organisational changes underway are necessary (and have been acknowledged by sector leaders), they have highlighted some underlying issues around how TEOs deliver for learners, undertake research, deliver the skills employers need, support economic growth, and improve society. As Minister, you hold several levers relating to the funding and financing of the sector that can drive specific outcomes.

113. The government needs to be clear on the outcomes it wants to achieve through tertiary education, which will influence any decisions around overall funding and the TEC's investment decisions. This includes the extent it may want to utilise incentives or create an environment that encourages greater economies of scale in programme delivery and/or the level of specialisation and differentiation – both within subsectors and across the entire tertiary system. It also includes decisions on key issues such as the degree to which the overall financial sustainability of the sector should be reliant on international fee income.

114. There are a range of mechanisms available to support you to progress these issues including the potential higher education funding and financing review, the proposed disestablishment of Te Pūkenga, and the Te Hono Wānanga work programme. The Ministry has recently provided you with advice on the higher education funding and financing review and you will need to decide on whether, and how, you wish to proceed with such a review (METIS-1319471).

115. We wish to engage with you on these issues and the levers you have available to utilise at your earliest convenience. We can then undertake further analysis or provide additional advice as required.

Tim Fowler
Chief Executive
Tertiary Education Commission
27 November 2023

Hon Penny Simmonds
Minister for Tertiary Education and Skills

5/12/2023

Appendix One: Risk assessments for all universities

	9(2)(b)(ii) [redacted]	Overall risk	9(2)(b)(ii) [redacted]
Massey			
VUW			
Otago			
Lincoln			
Waikato			
UC			
AUT			
Auckland			