Te Tāhuhu o te Mātauranga
Ministry of Education

Education Report: Transition of property funding for charter schools in Ministry-owned property

To:	Hon David Seymour, Associate Minister of Education Hon Nicola Willis, Minister of Finance		
Cc:	Hon Erica Stanford, Minister of Education		
Date:	29 August 2024	**Priority:**	High
Security Level:	In-Confidence	**METIS No:**	1334162
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Seen by the Communications Team:	No	**Round Robin:**	Yes

Purpose of Report

This report seeks your joint agreement to the transitional approach to property funding for charter schools using Ministry-owned property.

Alignment with Government priorities

The establishment of charter schools is a commitment under the National-ACT coalition agreement.

Summary

1. On 24 June 2024, Cabinet agreed to the proposed funding approach for charter schools, but authorised Joint Ministers (the Prime Minister, Minister of Finance, Minister of Education, and Associate Minister of Education) to make decisions on property funding matters [CAB-24-MIN-0217].

2. The final decisions from Joint Ministers included agreement to a five-year transitional approach to property funding for sponsors using Ministry-owned property. Further decisions to develop this transitional approach were delegated to the Associate Minister of Education and the Minister of Finance.

3. This paper seeks agreement to the:

    a. Trajectory of the five-year transition.
    b. Shifts in funding rates during the transition.

c. Implementation of the authorised split of capital maintenance funding allocation into capital funding and operating expense during the transition.

4. The decision on the implementation of the authorised split will determine the size and timing of the initial impact on the Crown's balance sheet.

Recommended Actions

The Ministry of Education recommends you:

a. **note** that following authorisation from Cabinet [CAB-24-MIN-217] Joint Ministers agreed that "to minimise any perverse or perceived financial incentive for State schools to convert" created by the agreed property funding approach "that a transitional approach to property funding for sponsors using Ministry-owned property is required".

Noted
Associate Minister of Education

Noted
Minister of Finance

Characteristics of the transition model

b. **note** that these decisions by Joint Ministers on the transition model for capital maintenance funding for all charter schools in Ministry-owned property included the following characteristics:

   a. Year One funding is "comparable to the capital funding budget allocated to schools and increase[s] over the following four years to be broadly equivalent to the total expected value of maintenance and renewal funding of similar State Schools",
   b. Over the first five years, sponsors will "take increasing responsibility to manage and maintain buildings that they occupy, with further recourse to the Crown decreasing to nil."

Noted
Associate Minister of Education

Noted
Minister of Finance

c. **agree** that before further recourse to the Crown decreases to nil in Year Five, that sponsors will have further recourse to the Crown, via the Ministry, for top-up capital funding in Years One to Four.

Agree / Disagree
Associate Minister of Education

Agree / Disagree
Minister of Finance

Recourse to Ministry during transition

d. **note** that in Years One to Four, sponsors (of converted charter schools) will have further recourse to the Crown for top-up capital maintenance funding and their top-up applications will be assessed and approved on the same basis as State schools (i.e. on a needs basis).

Noted
Associate Minister of Education

Noted
Minister of Finance

Trajectory of transition

e. **agree** that the level of guaranteed funding for capital maintenance (the funding rate) for charter schools in Ministry-owned property will increase in equal steps over the five years of the transition.

Agree / Disagree
Associate Minister of Education

Agree / Disagree
Minister of Finance

f. **note** that you have agreed that, to mitigate the risk of a breach of the Charter Schools | Kura Hourua MCA, the Charter School Agency should not contract with sponsors to open a charter school between March and June (METIS 1327993).

Noted
Associate Minister of Education

Noted
Minister of Finance

g. **agree** that schools shift up each stage of the transition model **EITHER**:

Option	Associate Minister of Education	Minister of Finance
i. **Option One**: On the anniversary of the conversion date	**Agree / Disagree**	**Agree / Disagree**
ii. **Option Two (recommended)**: At the end of the calendar year, with schools that convert after **1** March in any year to complete the following calendar year before progressing to the Year Two rate	**Agree / Disagree**	**Agree / Disagree**

h. **agree** that the funding rates at each step of the transition period will adjust in line with any changes to the full funding rate (Year Five).

Agree / Disagree
Associate Minister of Education

Agree / Disagree
Minister of Finance

Split of funding allocation during transition period

i. **note** that Joint Ministers agreed that to reduce the impact on the Crown's balance sheet while also incentivising sponsors to be more efficient and support the overall intent of the model, at least 70 percent of the funding for capital maintenance for Ministry-owned property will be provided to sponsors in the form of capital funding with the balance converted to an operating expense.

Noted
Associate Minister of Education

Noted
Minister of Finance

j. **agree** that the split of funding for capital maintenance into capital funding and operating expense (capex:opex), as approved by the Authorisation Board, be implemented during the transition period by **EITHER**:

Option	Associate Minister of Education	Minister of Finance
i. **Option One**: Authorised split applies from Year One *(e.g. 70:30 from Year One)* *Expected operating impact: $25.37m over five years'*	**Agree / Disagree**	**Agree / Disagree**
ii. **Option Two**: Authorised split applies from Year Five *(e.g. 100:0 Year One to Four)* *Expected operating impact: $8.75m over five years'*	**Agree / Disagree**	**Agree / Disagree**
iii. **Option Three**: Proportional increase to operating expense component from Year One culminating in the authorised split being applied in Year Five *(e.g. 94:6 in Year One, 70:30 in Year Five)* *Expected operating impact: $19.08m over five years'*	**Agree / Disagree**	**Agree / Disagree**
iv. **Option Four (recommended)**: Proportional increase to operating expense component from Year Three culminating in the authorised split being applied in Year Five *(e.g. 100:0 Year One and Two, 90:10 Year Three, 70:30 Year Five)* *Expected operating impact: $15.18m over five years'*	**Agree / Disagree**	**Agree / Disagree**

k. **agree** that the split of funding detailed in recommendation j, will only apply to the guaranteed funding (based on the funding rate) provided directly to sponsors and will not apply to any top-up funding.

Agree / Disagree **Agree / Disagree**
Associate Minister of Education **Minister of Finance**

Financial Implications

l. **note** that we will provide further advice in September on the capital-to-operating swaps necessary to give effect to the split of funding for capital maintenance into capital funding and operating expense.

Noted **Noted**
Associate Minister of Education **Minister of Finance**

m. **note** that the size and timing of the initial impact on the Crown's balance sheet of the operating expense component of the transition model will depend on the decision made in recommendation j.

Noted **Noted**
Associate Minister of Education **Minister of Finance**

Proactive Release:

n. **agree** that the Ministry of Education release this paper, with any necessary redactions, once it has been considered by you.

Agree / **Disagree**
Associate **Minister of Education**

Agree / **Disagree**
Minister of Finance

Jacqueline Sheppard
Senior Policy Manager
Te Pou Kaupapahere

29/08/2024

Hon David Seymour
Associate **Minister of Education**

1/9/24

Hon Nicola Willis
Minister of Finance

8/9/24.

Background

1. Following delegation from Cabinet (CAB-24-MIN-0217) to make decisions on property-based funding matters authorised Joint Ministers agreed that:

    a. "a transitional approach to property funding for sponsors using Ministry-owned property is required."
    b. "the property funding for charter schools in Ministry-owned property be comparable to the capital funding budget allocated to schools, and increase over the following four years to be broadly equivalent to the total expected value of maintenance and renewal funding of similar State schools."
    c. "the sponsors of charter schools on Ministry-owned property will, over the first five years of the school, take increasing responsibility to manage and maintain the buildings that they occupy, with further recourse to the Crown decreasing to nil."
    d. "at least 70 percent of the capital maintenance funding for Ministry-owned property will be provided to sponsors in the form of capital funding", with the balance converted to an operating expense and provided to sponsors.

2. These decisions were made to:

    a. "minimise any perverse or perceived incentive for State schools to convert";
    b. "reduce the impact on the Crown's balance sheet"; and
    c. "incentivise [sponsors] to be more efficient and to support the overall intent of the charter school funding model."

3. Further decisions needed to develop a transition of property funding for charter schools in Ministry-owned property, were delegated to the Associate Minister of Education and Minister of Finance to make joint decisions.

4. The capital maintenance funding rates for these schools for 2025 have been approved (METIS 1332981 refers). The examples in this report assume that funding rates do not change over time. In practice, they will change. We recommend that the rates for schools at each step of the transition adjust accordingly. By the end of October we will provide further advice on the approach to amending charter school funding rates over time to maintain broad equivalency with State school resourcing.

Characteristics of the transition model

5. The decisions to date by Ministers on the transition model for capital maintenance funding for charter schools in Ministry-owned property include the following:

    a. Year One funding is "comparable to the capital funding budget allocated to schools".
    b. Year Five funding is "broadly equivalent to the total expected value of maintenance and renewal funding of similar State Schools", based on the capital depreciation component within the School Property Management Portfolio appropriation.
    c. Over the first five years, sponsors will "take increasing responsibility to manage and maintain buildings that they occupy, with further recourse to the Crown decreasing to nil."

6. Recourse to the Crown decreasing to nil by Year Five implies that in Years One to Four, the sponsor will have some further recourse to the Crown for top-up capital funding.

Recourse to Ministry during transition

7. Until potential further recourse to the Crown for top-up capital maintenance funding ends in Year Five, sponsors will be able to seek additional capital funding from the Ministry in the same way that State schools do.

8. State schools must spend capital funding allocated to them as Five-Year Agreement (5YA) funding in line with Ministry requirements and prioritisation criteria. This means they must create a 10-year property plan, with support from the Ministry, which identifies projects (and allocates funding across those projects) in the five years following the development of the plan.

9. The prioritisation criteria for State school property plans are used to ensure the funding available is used on high priority and necessary projects first. The focus is on ensuring a school remains open and assets are maintained over time. The current criteria are:

Category	Current Description	Examples
Priority 1 **Health and Safety**	Projects to fix urgent health and safety issues that would close the school, or part of the school, if not addressed.	Includes defects that could harm people, like non-functioning sewerage systems or contaminated water supply Does not include small things like minor trip hazards in a car park.
Priority 2 **Essential Infrastructure**	Projects to maintain the integrity of building structures and services.	It does not include day-to-day preventative maintenance, such as gutter clearing.
Priority 3 **Fit for Purpose Learning Environments**	Projects to upgrade and enhance learning environments.	Examples are upgrades of classrooms to Design Quality Learning Spaces (DQLS) requirements and classroom reconfiguration.
Priority 4 **Discretionary Projects**	These projects are not essential and can only be carried out after all priority 1, 2 and 3 projects have been completed.	Examples are administration remodels, paving, carparks, and landscaping.

10. The Ministry funds Priority 1 and 2 work from the depreciation funding it holds centrally each year. If a State school needs a top-up to enable this work to happen, a funding request must be submitted. The Ministry will require any planned Priority 3 or 4 projects to be deferred.

11. If charter schools are to have further recourse to the Ministry during the transition period for top-up funding, they will be seeking funding from the same bucket of retained depreciation funding that State schools will.

12. We will assess and approve applications for top-up funding on the same basis as State schools against available funding. This will minimise any perverse or perceived incentive for State schools to convert, as well as minimise any perception of favouring charter schools over State schools,

13. This means that when making top-up funding applications during the transition period sponsors will need to provide evidence of property spending in line with relevant

Ministry requirements and prioritisation criteria. It will also mean they need to show they are deferring any Priority 3 or 4 work until Year Five when the potential for further recourse to the Ministry has reduced to ended. While there is a risk that Priority 3 or 4 work takes place before a request for further funding, this will be mitigated through the transition property plan.

14. Approvals will take account of the increasing property funding available to sponsors during and after the transition period. This means that if a project will not be completed within the funding year or the transition period, not all of the funding will be provided upfront as a top-up. Some of it will have to come from the higher level of property funding that the sponsor is being provided in later years.

15. Given the increase in funding available to sponsors during the transition period, we expect that requests for top-up funding will reduce throughout the transition.

16. To support a smooth transition of responsibility we will work with sponsors on a property plan that covers the transition period. Further detail on this is in METIS 1334159. Further detail on the management of property post-transition is in METIS 1334067.

Trajectory of transition

17. We need a decision on the trajectory of the funding level between Year One and Year Five. In line with the intent of the transition approach to minimise any perverse or perceived incentive to convert while supporting the overall intent of the charter school model, we recommend that funding increases evenly across the five years.

18. This means that, after Year One, funding would increase in four even steps between Year One and Year Five as illustrated below.

Funding rate	Illustrative Funding Trajectory
Year One rate	$1000
Year Two rate	$2000
Year Three rate	$3000
Year Four rate	$4000
Year Five rate	$5000

When will a charter school shift up each stage of the transition?

19. We expect most school conversions to occur at the beginning of the standard school year. You have agreed that the Charter School Agency (CSA) should not contract with sponsors to open a charter school between March and June (METIS 1327993 refers). We do not know whether some prospective sponsors may want to convert during the school year, or whether the Authorisation Board would approve them to do so. However, we need an approach that accounts for this possibility.

20. Schools could shift up each stage of the transition model on the anniversary of their conversion date. This would mean they transition to the full funding rate and full responsibility for property over exactly five years.

21. However, this approach would be more operationally complex to administer as schools would need to be tracked against their individual conversion date and have funding apportioned accordingly.

22. Alternatively, schools could shift up to the next stage of the model at the end of the calendar year, in line with the change in the school year. Without any parameters, this could lead to schools spending less than six months at the Year One rate.

23. Our preferred approach is to require a school that converts after 1 March in any year to complete the following calendar year before progressing to the Year Two rate. This will provide certainty, simplicity, and minimise any perverse or perceived incentive for State schools to convert. Since no school will convert between 1 March and the end of June, the longest a school would have at the Year 1 rate would be 18 months. We expect this would occur rarely, if at all.

24. Two examples of this approach are in the table below.

	Conversion Date	2026 Funding Rate	2027 Funding Rate
School A	25 February 2026	Year One rate	Year Two rate
School B	5 July 2026	Year One rate	Year One rate

Split of funding allocation during transition period

25. Joint Ministers have agreed that:

a. "at least 70 percent of the capital maintenance funding for Ministry-owned property will be provided to Sponsors in the form of capital funding".
b. "up to 30 percent of capital maintenance funding for Ministry-owned property will be converted to an operating expense and provided to sponsors".
c. the charter school authorisation board are authorised "to enter into negotiations with prospective sponsors to determine the appropriate funding split".

26. No decision has been made on the application of this funding split during the transition period. Any option will need to work in situations where the authorisation board approve a different split to 70:30.

27. We have identified four options:

a. **Option One** – Authorised split applies from Year One
b. **Option Two** – Authorised split applies from Year Five
c. **Option Three** – Proportional increase to operating expense component from Year One culminating in the authorised split being applied in Year Five
d. **Option Four** – Proportional increase to operating expense component from Year Three culminating in the authorised split being applied in Year Five

28. The table below outlines the proposed splits (Capex:Opex), assuming an authorised split of 70% capital funding and 30% converted to an operating expense.

Year	Option 1	Option 2	Option 3	Option 4
One	70:30	100:0	94:6	100:0
Two	70:30	100:0	88:12	100:0
Three	70:30	100:0	82:18	90:10
Four	70:30	100:0	76:24	80:20
Five	70:30	70:30	70:30	70:30

29. The approach needs to balance and account for:

   a. The intent of the transition being to minimise any perverse or perceived financial incentive for State schools to convert.
      i. Converting capital funding from the first year to an operating expense may be perceived as an incentive to convert.
   b. The intent of retaining capital funding being to reduce the impact on the Crown's balance sheet.
      i. The impact on the Crown's balance sheet begins once capital funding is converted to an operating expense.
   c. The intent of converting capital funding to an operating expense to be to incentivise sponsors to be more efficient and to support the overall intent of the charter school funding model.
      i. Sponsors should be incentivised to find efficiencies within the overall property funding during the transition period.
   d. The funding level in the early years, particularly Year One, will likely not be enough for sponsors to find efficiencies given likely property needs and costs.
      i. This means there is likely to be limited scope for non-capital related spend in the early years.
   e. Sponsors having further recourse to the Ministry during the transition period for additional capital depreciation funding on the same basis as State schools.
      i. Sponsor applications for top-up funding will be assessed and approved on the same basis as State schools, which means sponsors will have to spend all property related funding in line with State school requirements to be eligible.

30. Weighing all these factors we recommend Option 4. This option balances minimising any perverse or perceived incentive to convert and impact on the Crown's balance sheet against the intent on of the model to incentivise sponsors to find efficiencies. It also does not convert any funding to an operational expense in the years most likely to have limited scope for non-property spend, which avoids an unnecessary impact on the Crown's balance sheet.

31. As any top-up funding during the transition period will only be provided to support additional property work, we recommend that the authorised split of funding for capital maintenance does not apply to any top-up funding. This also aligns with the intent of the operating expense component being to incentivise sponsors to be more efficient.

Financial Implications

32. Giving effect to the split of funding for capital maintenance into capital funding and operating expense will require a capital-to-operating swap. The impact of this on the State system and charter schools will depend on the ratio of the swap (e.g. 1:1 or 10:1) which is yet to be determined. If the outcome is a 10:1 ratio this will disadvantage either State schools (not in line with Cabinet's decision) or charter schools which may require seeking additional funding through future budgets. Any option that does not apply the authorised split at the start of the transition period will allow time to work through this. We will provide further advice on this issue in September.

33. That there would be an impact on the Crown's balance sheet was considered by Ministers when property funding decisions were made. However, the timing and trajectory of the impact will differ depending on decisions made on this report. This is predominantly related to decisions on the implementation of the split of funding for capital maintenance into capital funding and operating expense during the transition period.

34. The Budget 24 package included funding for up to 35 State schools to convert to charter schools in 2025 and 2026. This included up to 15 conversions in the first year and up to 20 conversions in the second year. For illustrative purposes we have chosen a mix of primary and secondary school of various sizes to convert across these two years.[1]

35. Based on the assumptions above, we have calculated the potential operational expense component impact on the Crown's balance sheet of each of the four options from paragraphs 27 and 28. These are based on the confirmed 2025 funding rates. As with all other examples in this report, the figures below assume that the funding rate will not change over time.

Year	Option 1	Option 2	Option 3	Option 4
First Year (2025)	$0.87m	-	$0.18m	-
Second Year (2026)	$3.50m	-	$1.40m	-
Third Year (2027)	$5.25m	-	$3.15m	$1.75m
Fourth Year (2028)	$7.00m	-	$5.60m	$4.68m
Fifth Year (2029)	$8.75m	$8.75m	$8.75m	$8.75m
Overall five year impact	$25.37m	$8.75m	$19.08m	$15.18m

Next Steps

36. Final decisions will be communicated to prospective sponsors.

[1] This includes 6 Primary and 9 Secondary in 2025, and 9 Primary and 11 Secondary in 2026.