

# Report: Further advice on 2026 VET funding decisions

To:	Hon Penny Simmonds, Minister for Tertiary Education and Skills		
Date:	25 October 2024	Deadline:	29 October 2024
Security Level:	In-Confidence	Priority:	High
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## Why are we sending this to you?

- You are receiving this to support additional discussion about changes to vocational education and training (VET) funding, as part of your broader VET system redesign.

## What action do we need, by when?

- We would like to discuss the contents of this report with you at our meeting on Tuesday 29 October 2024.

## Key facts, issues and questions

- For your December 2024 Cabinet paper you will need to indicate the main changes that you would like to make to the VET funding system, including the fiscally neutral rebalancing of funding between different elements, at a high level.
- This report provides advice, based on initial discussions with you on 17 October, regarding achieving fiscal neutrality and the division of funding for work-based learning between providers and proposed Industry Skills Boards.

## Alignment with Government priorities

1. This report supports the redesign of the vocational education and training (VET) system, which is one of your priorities for the Tertiary Education and Skills portfolio.

## Context

2. On 17 October we discussed indicative options for how funding for the redesigned VET system would be rebalanced to support your objectives [METIS 1336884 refers].
3. In that discussion you indicated that your preferred options were:
  - a. **Provider-based funding rates:** explore an increase between Options A (a 4% increase) and B (an 8% increase), potentially with some targeting of increases.
  - b. **Learner Component:** make savings of approximately \$20 million, through removing the Māori and Pacific learner criteria and making some reductions to the funding rates for learners with low prior achievement and disabled learners.
  - c. **Work-based learning (WBL):** proceed with Option A (a decrease in the order of 10%), with this funding repurposed towards standard setting.
  - d. **Standards-Setting:** proceed with Option A (funding standard-setting at \$30 million).
  - e. **ITP Fund:** establish a small ITP fund (up to \$15 million) to be divided equally between ITPs, intended to recognise the unique role they play for their regions and communities.
4. You have indicated agency savings should contribute to ensuring that the rebalancing of funding across the system is fiscally neutral. Without agency savings, we estimate that the costs of the above settings would exceed savings by between \$2 million and \$39 million (depending on the level of provider-based increase and the size of any ITP fund). This report provides further advice on options for achieving fiscal neutrality.
5. Under the Hybrid model, the overall pool of funding for WBL would be divided between providers of education functions and the Industry Skills Boards (ISBs) which provide pastoral care. While the specific division and precise rates will not be decided on until 2025, this report highlights some of the key considerations around that division.

## Balanced Funding Models

6. Based on your feedback, we have assumed that total WBL funding should be reduced by \$30 million to fund standard-setting, but not reduced further. We also understand that the size of any ITP fund should be dependent on the ability to reprioritise agency savings towards this purpose. The key remaining trade-off would therefore be between the size of the funding increase for provider-based delivery funding, and the size of the funding reduction for the Learner Component.
7. For provider-based delivery funding you indicated a preference for either Option A (a small increase of 4 percent) or somewhere between Option A and Option B (an increase of 8 percent, returning to the cost-adjusted equivalent of pre-UFS levels). Table 1 shows two options for achieving this. The impact of an ITP fund is excluded in this calculation, but discussed below.

8. Under either option, increases to provider-based delivery funding could be targeted toward priority provision rather than spread evenly across delivery. Targeting would be a subsequent decision and will not need to be confirmed for the December Cabinet paper.

*Table 1: Options for the distribution of core VET funding*

Options	Provider-based <sup>1</sup>	Work-based	Learner Component	Standard setting	Total
Option 1	\$572m (+4%)	\$260m (-10%)	\$48m (-31%)	\$30m	\$910m
Option 2	\$583m (+6%)	\$260m (-10%)	\$37m (-50%)	\$30m	\$910m

9. Option 1 involves a slightly larger reduction to the Learner Component than what you signalled (\$22 million rather than \$20 million) to fund a 4 percent increase to provider-based funding. After removing the estimated \$5.5 million allocated for Māori and Pacific learners this constitutes a 26 percent reduction to the remaining Learner Component. If this were spread evenly between low prior achievement and disabled learner rates this could allow for a rate of approximately \$980<sup>2</sup> per learner (compared to \$1,327 at present), but you will have options for how you configure these rates.
10. Option 2 would require a larger reduction in Learner Component funding, which is likely to have flow-on effects for how TEOs prioritise support for priority learner groups [METIS 1336884 refers]. However, this would facilitate a larger increase in delivery funding for providers. After removing the estimated \$5.5 million allocated for Māori and Pacific learners this constitutes a 43 percent reduction to the remaining Learner Component. If spread evenly between low prior achievement and disabled learner rates this could allow for a rate of approximately \$750<sup>2</sup> per learner.
11. On balance we recommend Option 1. This option is closest to the overall preferences you have previously indicated, and allows a reasonable amount of Learner Component funding to be retained and directed toward your chosen learner criteria. While the increase to provider-based funding is smaller than some options, it would be additional to the substantial increase already agreed for 2025 and the neutralisation of the extramural mode. Because the provider-based funding pool is the largest in the VET system, increasing it further would require a large reduction of another system element which could have a disproportionate negative impact on that part of the system.
12. A larger Learner Component reduction may also not be consistent with the feedback provided by Minister Willis and Minister Upston that the system change should be focussed on meeting the needs of learners. The Ministry of Social Development has highlighted to Minister Upston that reductions in the Learner Component (as well as reduced programme offerings in VET) could reduce incentives on providers to support underserved learners, increasing demand and cost for programmes within her Social Development portfolio.
13. We suggest that your chosen option is reflected at a high level in your upcoming Cabinet paper. At this stage the exact percentage shifts would not need to be confirmed. Approximate figures (e.g. approximately 30 or 50 percent of the Learner Component) can

<sup>1</sup> For the purposes of this exercise, each one percent increase to total provider-based funding is estimated at \$5.5 million.


<sup>2</sup> Note that this has been calculated based on high level numbers and a percentage reduction of 2025 rates. We will do further work (including incorporating updated learner data and forecasting) to inform future advice on funding rates for 2026.

be provided to give a sense of the scale of shifts while leaving space to refine if necessary. More detailed settings, including how funding will be split across funding rates, can be confirmed in a future Cabinet paper establishing funding proposals in early 2025.

### ***Impacts of the options***

14. Table 2 shows estimates of how these options would impact funding allocations for individual ITPs and VET subsectors. We have included impacts for WBL based on the current delivery model in order to show the combined impact of reductions in WBL funding rates and the Learner Component. We are not yet in a position to allocate this funding to either ITPs or ISBs under the Hybrid model, noting uncertainty about which providers will pick up which WBL delivery and the way in which this funding will be split (as discussed below).
15. The estimates below were reached by applying the proportions of total funding that different providers received in 2023 to the working baselines for 2026 used in Table 1, and then adjusting for the options. We have assumed funding changes are evenly distributed, and this will be subject to change based on the targeting of funding rate increases and any changes in providers' mix of provision as part of financial sustainability work. The relative impacts should be taken as indicative only, pending more complete modelling.

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16. Your decisions on funding rates will differ from the modelling assumptions used by the Specialist Advisors and will have implications for their analysis. In particular, the Specialist Advisors assumed a return to full SAC-equivalent funding rates from 2025 with a corresponding larger reduction in the Learner Component. In general, the rates set for 2025 and your indicative decisions for 2026 provide a slightly smaller and more staged increase to provider-based delivery. Your decisions on this paper can be communicated to the Specialist Advisors to be factored into their analysis.
17. There will be some variation in the impacts for individual providers if you choose to target increases to provider-based funding rates to priority provision rather than applying an increase across all provision. Similarly, the full impact of Learner Component funding will depend on the final settings and each provider's learner demographics in 2024. These differences may be significant for particular programmes, but we do not expect enough variation to make a substantial difference in provider viability. Modelling will continue to be updated as decisions are made.

## ITP fund design and agency savings

### *Proposed ITP fund design decisions may raise questions about accountability*

18. You indicated that you would like to proceed with a small ITP fund of up to \$15 million, to be divided equally between ITPs, to recognise the unique role they play for their regions and communities. You also indicated that you would want to limit accountability arrangements to reporting via annual reports and investment plans.
19. While your indicative design decisions will minimise the compliance costs and operational complexity of an ITP fund, this is likely to raise questions about whether the accountability arrangements are sufficiently strong to ensure good use of public funds, particularly in the current fiscal environment. Other Ministers may question the outcomes associated with this funding and how we ensure that it represents good value for money. While the detailed settings do not need to be confirmed for your December Cabinet paper, we would suggest signalling that ITPs would need to clearly articulate how this funding will be used as part of their investment plans, with reporting on the outcomes of this investment in annual reports.
20. Alternatively, if an ITP fund is smaller in size you could consider targeting this funding toward ITPs that are smaller, more remote, or which have specific at-risk provision. This would likely need to be done via grants to individual ITPs under section 556 of the Education and Training Act 2020 (rather than by TEC-administered funding). These grants are required to be in the national interest, so would need to be justified based on the specific circumstances and roles

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<sup>3</sup> Work-based learning figures include the shift of approx. \$30 million to fund standard-setting as well as reductions in the Learner Component (more than half of which is allocated to work-based learning).

of the providers in question, and could be ended if no longer required to support particular providers.

### ***The size of an ITP fund would be dependent on agency savings and your overall Budget strategy***

21. You have indicated your intention to repurpose departmental savings from tertiary education agencies to support the VET funding system. You will receive advice on savings options and trade-offs required in the near future [METIS 1338638 refers]. Until you have made decisions about the specifics of potential savings, we are unable to accurately factor them into the balance of VET funding.
22. Repurposing these savings to support VET delivery will also require the approval of the Minister of Finance as part of your overall Budget strategy. The general expectation for the Budget is that that agency savings would be returned to the centre, although the Minister of Finance could agree to a different approach in these circumstances.
23. Given that you have signalled that agency savings should be reprioritised towards an ITP fund, we suggest signalling this at a high level in the Cabinet paper. The paper could note that you are exploring options to support the regional role and importance of ITPs as part of your overall Budget strategy for 2025, including the option of reprioritising agency funding. Final decisions on the size and nature of an ITP fund could then be made in early 2025 alongside detailed changes to funding rates for 2026.

### **Balancing Funding for Providers and ISBs in Work-based learning**

24. In discussing your overall views on allocating funding to different elements of the system on 17 October [METIS 1336884 refers], we raised the issue of how the total pool of funding for work-based learning would be allocated between providers and ISBs.
25. Under the Hybrid model, the work-based learning pool will need to support two separate sets of functions:
  - a. regionally-organised education functions (programme and resource development, and assessment in a range of modes) managed by individual providers; and
  - b. nationally-organised coordination and pastoral care functions managed by ISBs.
26. These functions have historically been funded together, enabling integration and cost-sharing. For example, in some WBL divisions a training advisor may support an apprentice with regular pastoral care visits and then be responsible for assessment when the learner is ready. Dividing these functions between ISBs and providers will reduce opportunities to share costs between them. Moving education functions from a single national organisation to multiple regional providers may also have cost implications.
27. It may be challenging to adequately fund these as separate functions to be offered by different organisations. Under the Hybrid model, the post-split funding must be sufficient to ensure that each function is viable in its own right. Across the system the average funding rate per STM under your proposed settings would likely be approximately \$6,500, (although the relatively low credit loads of work-based learners mean that funding per learner would



be significantly lower).<sup>4</sup> Within this, WBL rates for providers must be set at a sustainable level to support what could be relatively small regional programmes in terms of STMs; this will be a particular concern for smaller and specialist trades who rely on national scale to be viable. ISB rates must be set at a level that enables them to maintain an effective pastoral care system that operates across all parts of the country.

28. We do not currently have robust estimates for what might constitute viable funding levels for each of these functions, although the TEC has begun a modelling process to estimate the costs involved in establishing and operating ISBs. We believe that it should be possible to support both functions with the 10 percent reduction to overall WBL funding (to support standards-setting) that you have signalled, although this will require some trade-offs in terms of the activities that can be expected of providers and ISBs.
29. There are other factors that you may wish to consider as part of setting this balance. For example, in advice earlier in the year [METIS 1324004 refers] we discussed the option of shifting from the multiple subject-based funding rates in the UFS, to the sector-neutral but tiered funding rate approach used for the previous industry training system.<sup>5</sup> Conversely, you may wish to set different provider-to-ISB ratios for different subject areas to recognise different costs of delivering pastoral care to different types of work settings.
30. **Annex 1** provides further information on considerations for setting an appropriate balance in the division of this funding.
31. As an indication of actual rates is not needed until early 2025, we recommend that your December Cabinet Paper provide a high-level overview indicating that:
  - a. you intend to apply a 10 percent reduction to current work-based learning funding to support standards-setting by ISBs;
  - b. the remaining funding pool will be allocated between these two functions; and
  - c. you intend for the majority of this funding to be allocated to the education function, but that further detail will be provided in your early-2025 Cabinet Paper.
32. We and the TEC will then provide you with further advice and modelling to support specific content and proposals in your 2025 Cabinet Paper, including initial analysis of the potential design and cost structures of ISBs.

## Next Steps

33. We would like to discuss the contents of this report as part of our meeting with you on Thursday 29 October.
34. The results of that discussion will inform the content of your December Cabinet Paper, as well as future advice from officials on ISB viability and funding of the system.
35. Once the content of your December Cabinet paper is confirmed we will provide you with further advice on a proposed process for finalising funding decisions, working toward a further Cabinet paper in early 2025.

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<sup>4</sup> In 2023, the average work-based learner accounted for 0.38 STMs, and the average UFS subsidy per work-based learner across the system was \$2,594 (excluding elements funded at an off-job rate).

<sup>5</sup> Industry training trainees attracted the same rate regardless of sector: \$3517 per STM (the equivalent of EFTS) in the final year before the UFS. However, apprentices – who engaged in longer programmes at higher levels with more pastoral care – attracted a higher rate: \$5,716 per STM (a \$2,200 premium).

## Recommended Actions

The Ministry of Education recommends you:

a. **indicate** your preference for funding shifts:

- i. **Option 1** (approx. \$22 million from Learner Component to provider-based delivery)

**Yes / No**

OR

- ii. **Option 2** (approx. \$33 million from Learner Component to provider-based delivery)

**Yes / No**

b. **agree** that your December Cabinet Paper will include (with detail to follow in early 2025):

- i. an overview of the key proposed funding shifts in the VET system and their implications

**Agree / Disagree**

- ii. a high-level discussion of your approach to balancing provider and ISB funding for work-based learning

**Agree / Disagree**

- iii. signal that you are exploring the option of establishing a fund to support the unique role of ITPs as part of your wider Budget strategy, dependent on the reprioritisation of agency savings

**Agree / Disagree**

### Proactive Release:

- c. **agree** that the Ministry of Education release this paper after Cabinet has taken further policy decisions on VET funding in Q1 2025, with any information needing to be withheld done so in line with the provisions of the Official Information Act 1982.

**Agree / Disagree**



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**Tertiary Education and Evidence**  
25/10/2024

Hon Penny Simmonds  
**Minister for Tertiary Education and Skills**

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## Annexes

The following are annexed to this paper:

Annex 1: Further information on dividing work-based learning funding between providers and ISBs

Proactively Released

## Annex 1: Further information on dividing work-based learning funding between providers and ISBs

***There will be challenges in setting an appropriate balance, and trade-offs will be required***

1. Estimating the likely costs to providers and to ISBs of working within the Hybrid model is complicated by the diversity of current models between industries. For example, the MITO division of Te Pūkenga employs 45 training advisors across the country, while the HITO division employs nine. While there may be scope to change some models to reflect the rebalancing of funding, in other cases firms, learners, and industries will expect a high level of continuity from both the provider and the ISB. Shifts away from on-job assessment and pastoral care may be perceived as reductions in service quality.
2. Ultimately, the costs of both assessment and pastoral care will depend on the models adopted by a provider, and conversely the potential models that can be adopted will be driven by the funding available. Broadly, the lower the level of funding the more 'light touch' each will need to be, with online models and learner-initiated access to support taking precedence over direct engagement with learners and employers in firms and workplaces. Deciding whether education or pastoral care functions require more direct engagement with learners and firms will be a key consideration.

### ***Ongoing costs for providers***

3. Providers will face start-up costs in taking on programmes from WBL divisions, especially in terms of staff costs. For example, while programmes may transfer to more than one provider, programme developers and designers at a WBL division cannot. Similarly, an ITP may need to replace WBL division assessors who operated nationally or who have moved to an ISB due to their pastoral care role. This will need to be accounted for in determining which providers can receive WBL division programmes.
4. On an ongoing basis, however, and notwithstanding back-office functions such as credit reporting, the 'education' function involves two key sources of cost: programme development and assessment. As providers will either already have or have received from WBL divisions the existing programmes and associated intellectual property (e.g. learning and assessment resources) for their programmes, they are unlikely to need to invest immediately in developing new programmes. In the short term, the most significant ongoing cost to a WBL provider is likely to be managing a new assessment function.
5. Research shows that good practice in work-based assessment – especially for 'apprenticeship'-style programmes – involves assessing in the workplace with the involvement of both learners and employers.<sup>6</sup> However, these are more expensive and also more variable in cost (it is less expensive to offer field assessment on urban construction sites than on remote farming and forestry workplaces). Other models, such as remote assessment of workbooks or completion of online exercises, are less expensive and more standardised but offer a less comprehensive evaluation of competence.
6. In addition to viability, you will need to consider the incentives created by funding differentials between provider-based and work-based learning. If these are too significant, providers will likely prioritise provider-based programmes over beginning or continuing to

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<sup>6</sup> Vaughan & Cameron (2009; 2010); Vaughan, Gardiner & Eyre (2012); Alkema & McDonald (2016).

offer work-based programmes. This would have a significant impact for industries such as agriculture and construction, where work-based programmes dominate the skills pipeline.

7. For example, a large difference between extramural and work-based rates could encourage providers to re-package the programmes they receive from WBL divisions as 'provider-based extramural' programmes. The provider would receive significantly more funding for these programmes, and would not need to involve an ISB in their relationship with the learners in that programme (which they may see as a compliance burden). Such a shift would undermine the Hybrid model, significantly increase costs to the Government, and could compromise the viability of ISBs.

### ***Ongoing Costs for Industry Skills Boards***

8. You have decided to use the Modern Apprenticeship Coordinator (MAC) role as a model for our expectations of ISB coordination and pastoral care functions [METIS 1336340 refers]. At the time that scheme ended (2014) coordinators received approximately \$2000 per learner. A similar rate was applied – though per-STM – as the apprenticeship premium under the previous industry training scheme; this in part reflected the additional pastoral care expected of an ITO under the Apprenticeships Code.
9. In both cases, however, this funding built on an underpinning level of coordination and support that an ITO was expected to provide. ITOs were able to charge fees and their core STM funding supported pastoral care; as noted above, many developed business models that integrated their arranging, assessment, and pastoral care activities into a single service. The cost of providing a national pastoral care service on its own may be higher than providing a combined service.
10. You have also indicated that you envisage the firm-level engagement of ISBs supplementing and supporting the industry-level engagement currently undertaken by WDCs. This will require a pastoral care model that is more active and 'high-touch' than was supported by some ITOs in the past, and which is more expensive to maintain.

### ***ISBs will have less control over their costs and income than providers***

11. Unlike providers, ISBs will not be able to charge fees to support their pastoral care function and will not be able to draw on their system-level standards-setting activities to support or cross-subsidise those functions.<sup>7</sup> In addition, while providers can choose to exit from WBL programmes if they prove uneconomic, an ISB cannot choose to withdraw from providing pastoral care. The involvement of the ISB alongside a provider is the core of the Hybrid model, and will be a statutory function that they must fulfil for every trainee and apprentice enrolled at each provider.
12. This means that in practice, ISBs' sole source of funding for pastoral care will be the public subsidies that they receive from the government, and their income and a large element of their costs will effectively be determined by providers' decisions rather than the ISBs themselves. If funding for pastoral care creates very tight margins, this will make ISBs' overall financial situation highly sensitive to changes in both local and national economies and whether providers choose to maintain, expand, or exit their work-based programmes.

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<sup>7</sup> ISBs will have the ability to levy industry and charge providers fees for standards-setting, but their ability to use these to subsidise pastoral care activities will be heavily constrained.