



Tertiary Education Report: Crown loan to the Western Institute of Technology at Taranaki

Date:	8 July 2021	TEC priority:	High
Security level:	In Confidence	Report no:	B-21-00385
Minister's office No:			

ACTION SOUGHT			
	Action sought	Deadline	
Hon Chris Hipkins Minister of Education	Agree/disagree to convert the remaining balance of the Western Institute of Technology at Taranaki Limited's Crown loan of \$4.1568 million to equity.	At your earliest convenience	
Enclosure: Yes	Round Robin: No		

CONTACT FOR TELEPHONE DISCUSSION (IF REQUIRED)				
Name	Position	Telephone	1st contact	
9(2)(a)	Principal Advisor	9(2)(a)		✓
Gillian Dudgeon	DCE, Delivery	9(2)(a)		

THE FOLLOWING DEPARTMENTS/AGENCIES HAVE SEEN THIS REPORT

- | | | | | | | |
|-------------------------------|------------------------------|-------------------------------|-------------------------------|---|---|--|
| <input type="checkbox"/> DPMC | <input type="checkbox"/> MPI | <input type="checkbox"/> ENZ | <input type="checkbox"/> ERO | <input type="checkbox"/> MBIE | <input checked="" type="checkbox"/> MoE | <input type="checkbox"/> MFAT |
| <input type="checkbox"/> MPP | <input type="checkbox"/> MSD | <input type="checkbox"/> NZQA | <input type="checkbox"/> NZTE | <input checked="" type="checkbox"/> TEC | <input type="checkbox"/> TPK | <input checked="" type="checkbox"/> Treasury |

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 Withdrawn |

Comments:

Recommendations

Hon Chris Hipkins, Minister of Education

It is recommended that you:

1. **note** that in 2009, Cabinet agreed that Western Institute of Technology at Taranaki (WITT) would retain a non-interest bearing Crown loan of \$5.196 million repayable in equal annual instalments over five years between 2020 and 2024;
2. **note** that WITT made its first payment of \$1.0392 million on 31 December 2020, with an outstanding balance to the Crown of \$4.1568 million;
3. **note** that Te Pūkenga has formally requested that the Crown loan balance owing by WITT be converted to equity or forgiven to support the ongoing financial sustainability of the subsidiary and enable progress towards addressing significant deferred maintenance liabilities;
4. **note** that the Treasury has advised that to convert the loan to equity would not require it to be charged against allowances and so there would be no fiscal implications for the Crown;
5. **note** that converting the loan to equity would support WITT's financial position and its ability to address deferred maintenance, although it would result in the Crown forgoing the repayment amount^{9(2)(g)(i)}
[REDACTED]
6. **agree** to convert the remaining balance of WITT's Crown loan of \$4.1568 million to equity;

AGREE / DISAGREE

7. **note** that if you do wish to convert the loan to equity, we will provide a briefing to Joint Ministers to give effect to the decision; and
8. **agree** that the Tertiary Education Commission proactively release this briefing once decisions have been made.

AGREE / DISAGREE



Gillian Dudgeon

Deputy Chief Executive, Delivery
Tertiary Education Commission

8 July 2021

Hon Chris Hipkins

Minister of Education

____ / ____ / ____

Purpose

1. The purpose of this briefing is to seek your decision on converting to equity the remainder of Western Institute of Technology at Taranaki Limited's (WITT's) historical Crown loan, which totals \$4.1568 million.

Request to convert the Crown loan to equity

2. On 18 December 2020, the Chief Executive of Te Pūkenga wrote to the Tertiary Education Commission (TEC) formally requesting that the Crown loan balance owing by WITT be converted to equity or forgiven to support the ongoing financial viability/sustainability of the subsidiary and enable progress towards addressing significant deferred maintenance liabilities.
3. WITT's revenue base is the second smallest across Te Pūkenga's network (behind Tai Poutini Polytechnic Limited) and its capital asset strategy work has identified that its New Plymouth campus has significant deterioration and is also of high strategic value. Te Pūkenga notes that due to its scale, WITT has limited ability to drive significant operating cashflows to address these matters in addition to making repayment of the remaining Crown loan.
4. The letter notes that the requirement to repay the Crown loan places WITT in a difficult position to meet the increased demand of the domestic market while at the same time managing the reduced demand in international students and addressing key deferred maintenance initiatives. As such, it seeks the Crown loan to be converted to equity. A copy of the letter from Te Pūkenga is attached to this briefing.

Background to WITT's Crown loan

WITT's loan was the result of financial difficulties in the mid-2000s...

5. A number of years of financial difficulties at WITT resulted in the Crown providing loans totalling \$17.618 million as well as the replacement of its Council with a Crown Commissioner in December 2006. In July 2008, the Government agreed to a "repair and rebuild" strategy for WITT that included converting the balance of the Crown loans to equity over the following five years, subject to performance targets being met [SDC Min (08) 11/3 refers].
6. In August 2009, the new National Government reviewed this decision and considered that retaining some debt, repayable at a future date, would strengthen incentives on WITT to achieve its recovery strategy whilst constraining its ability to incur further debt. As such, Cabinet agreed [CAB Min (09) 30/12 refers] that:
 - WITT would retain a non-interest bearing Crown loan of \$5.196 million repayable in equal annual instalments over five years between 2020 and 2024; and
 - The balance of the outstanding Crown loan (\$12.422 million) would be established as a suspensory loan, convertible to equity on the achievement of agreed performance measures over five years from December 2009.
7. Throughout the following five year period, WITT met the key performance measures that had been set for the annual conversion of the suspensory loan. Consequently, by 31 December 2013, the full amount of the \$12.422 million loan had been converted to equity.

...and the first instalment of the \$5.196 million loan was repaid at the end of 2020...

8. The Crown loan agreement with WITT requires \$1.0392 million be paid at the end of each calendar year between 2020 and 2024. The first payment of \$1.0392 million was made by WITT to the Ministry of Education (MoE) on 31 December 2020. Consequently, a total of \$4.1568 of the Crown loan remains.

...but the WITT subsidiary has limited ability to repay the debt to the Crown going forward...

9. WITT has historically had ongoing financial viability and sustainability issues. Prior to the establishment of Te Pūkenga, the TEC assessed WITT as 'high risk' and an independent financial advisor to WITT's Council was in place from 2017 to 31 March 2020 when WITT became part of Te Pūkenga.
10. WITT reported a deficit of \$1.3 million (4.8 percent of revenue) for 2020 against a budgeted deficit of \$0.8 million. 9(2)(b)(ii) [REDACTED] WITT has not achieved an underlying surplus since 2015.
11. At the end of 2020, WITT had \$2.5 million in cash reserves. With another deficit forecast in 2021 and a scheduled further Crown loan repayment of \$1.0392 million at the end of the year, 9(2)(b)(ii) [REDACTED] Based on these forecasts, WITT will be able to make its 2021 payment, however it is likely that its 2022 position will become difficult to manage. It will have trouble managing any liquidity risks itself and be unable to undertake any significant capital expenditure.

...therefore the Te Pūkenga parent would need to provide support

12. If WITT had remained an independent tertiary education institution, it is unlikely that it would have had the ability to repay the Crown loan without some level of Crown support and there would have been a significant risk of it running out of cash. 9(2)(g)(i) [REDACTED] However, the establishment of Te Pūkenga in April 2020 means that WITT is now part of a wider group.
13. As we have previously advised, Te Pūkenga has established a group treasury strategy which allows it to move cash (excluding ring-fenced cash reserves) around the network to where it is needed. 9(2)(b)(ii) [REDACTED] As such, if WITT is unable to make any repayments on the Crown loan, it has the ability to seek support from the Te Pūkenga group. We consider it is likely that WITT would need to begin doing this from 2022, if not from late 2021 if financial performance is worse than expected.
14. While Te Pūkenga has the ability to fund WITT's repayment of the Crown loan, given its financial position and the need to fund its transformation programme over coming years, it is seeking that WITT's loan is converted to equity. In essence, Te Pūkenga would prefer to use those funds to drive its transformation programme and implement its new operating model rather than support WITT's cash position.

Ability to convert the Crown loan to equity and fiscal implications

15. We have consulted with the Treasury on the fiscal implications of converting the loan to equity. Currently, MoE has \$4.156 million as a receivable given the required repayment. The Treasury has noted that to convert the remainder of WITT's loan, MoE would need to remove the receivable of \$4.156 million and increase its investment into Te Pūkenga by the same amount. The increase to its investment into Te Pūkenga would need to be appropriated, even though it would be a non-cash transaction and no funding source would be required to do the conversion. There would be no impact to MoE's or the Crown's operating balance or asset level.
16. There would be no fiscal implications to the operating balance or net core Crown debt given the original decision to issue the loan was charged against the capital allowance at the time.
17. There is a historical Crown loan agreement with WITT that was signed by the then Minister of Finance and Minister for Tertiary Education. The agreement allows the Minister of Finance to alter any of the terms and conditions of the Crown loan agreement. We therefore consider that agreement by the Minister of Finance and yourself to convert the loan to equity would be sufficient.

The TEC's view

18. There is an understandable rationale for WITT and Te Pūkenga's request to convert the Crown loan to equity given WITT's financial position, historical deferred maintenance, and Te Pūkenga's objective of making the sector more financially sustainable. Converting WITT's Crown loan to equity will allow it to address some maintenance issues and probably better respond to the increase in student enrolments. It will also mean that Te Pūkenga does not have to provide cash support to WITT, which is almost a certainty if the Crown loan is not converted to equity.
19. WITT has recently announced that it considers around \$100 million needs to be invested in its campus over the next four to ten years to deliver to the needs of the Taranaki region and support a just transition to a low emissions economy. The Ministry of Business, Innovation and Employment has been engaging with WITT on this work. WITT's capital requirements will feed into Te Pūkenga's overall capital strategy.
20. While there are advantages of converting the loan to equity, there are also some key disadvantages. Firstly, there is a question of what value the Crown would obtain from gaining equity in WITT. In reality, this investment would have no value and the Crown would forgo \$4.1568 million in expected repayments. Secondly, if Ministers were to agree to convert WITT's loan to equity, 9(2)(g)(i)
[REDACTED]
[REDACTED]
[REDACTED]
21. If a decision is made to not convert the loan to equity, we do not see any immediate risks for students or the network. While WITT has capital expenditure needs, so do many other subsidiaries, and these can be highlighted and addressed through Te Pūkenga's wider capital asset strategy work stream. As we recently noted to you (AM-21-00324 refers), Te Pūkenga expect to identify a list of high-priority projects by the end of July 2021. However, given Te Pūkenga's financial position, it will have limited ability to fund subsidiary capital programmes.
9(2)(f)(iv)
[REDACTED]
22. In the lead-up to the formal establishment of Te Pūkenga, officials had proposed writing off WITT and UCOL's historic Crown loans as part of a broader fiscal strategy for funding Te Pūkenga and other components of the Reform of Vocational Education [METIS 1218370]. However, the emergence of COVID-19 led to a two-stage approach to funding Te Pūkenga that did not include writing off WITT's loan. Following Te Pūkenga's letter to the TEC in late 2020 regarding converting WITT's loan to equity, we have engaged with Te Pūkenga on this issue a number of times. Both WITT and Te Pūkenga are keen that Ministers make a decision on this issue in the near future to assist it with future planning.
23. We have consulted with the Treasury and MoE on this briefing and their feedback has been incorporated. The Treasury does not support the Crown loan being converted to equity due to the lack of value that would be gained from converting the loan to equity 9(2)(g)(i)
[REDACTED]

Next steps

24. If you agree not to convert WITT's Crown loan to equity, we will inform WITT and Te Pūkenga that we have consulted with you and the Government does not wish to convert the Crown loan to equity.
25. If you decide that you would like to convert WITT's Crown loan to equity, we will provide the Minister of Finance and yourself with a briefing to give effect to this decision. Although we consider the decision to convert the Crown loan to equity can be made by Joint Ministers, you may also want to take an oral item to Cabinet.
26. We are available to discuss this issue with you at the next agency meeting.