****

**FOR ADVISORY GROUP USE ONLY**

**DRAFT – NOT GOVERNMENT POLICY**

# Review of Funding Systems

# Background paper for Advisory Group

**Property and property-related services**

24 June 2016

**Review of Funding Systems: Property and property-related services**

Introduction

This proposal is focussed on operational funding for property and property-related services, particularly funding currently provided as part of operational grant.

Funding for utilities, currently provided via the Heat, Light and Water component of the operational grant, is in scope due to the connections between building design/systems and utilities use.

The allocation of capital funding (eg Five Year Agreement funding) is out of scope, but the Review of Funding Systems will consider how operating and capital funding can be better aligned to ensure better whole-of-life decision making and minimising whole-of-life costs for school property assets.

The Review provides a timely opportunity to investigate whether a closer connection between the funding and management of property and utilities operational costs will lead to better outcomes.

Overview

Under Tomorrow’s Schools, boards of trustees are accountable for both educational and asset management outcomes. Funding systems, particularly regarding operational expenditure, currently provide significant flexibility for boards of trustees to determine how much to spend on asset management and how much on educational initiatives.

The current arrangements mean that boards of trustees and principals must trade off time and money spent on property management with time and money spent on educational outcomes. In addition, the current arrangements have not led to consistently good asset management outcomes and the Ministry of Education has not been asked to view operational property costs in any other way than as a funder.

In the context of wider changes contemplated to funding systems, a greater focus on funding on a per student basis presents a challenge when thinking about infrastructure funding, as the size of the roll may not be a significant factor in asset and utilities management costs.

One option is that funding for some property-related expenses are removed from the operational grant (or Global Budget, if progressed) and ‘ring-fenced’ so that the funding must be spent on specific activities.

Some property-related services are currently centrally managed (eg Building Warrants of Fitness) and as part of this work we are considering what other elements might be better centrally managed to better leverage the size of the portfolio and lessen the burden of property management on boards and school leaders.

Across operational property-related funding, the Ministry has very limited operational and or management data. One of the key objectives of this work is to increase our understanding from the perspective of all stakeholders.

The current state

The operational grant that state and state-integrated schools currently receive includes:

* a Property Maintenance grant (c. $90 m per annum, or 7% of total operational grant funding) - formula based on a limited number of property characteristics of the school);
* a Heat, Light and Water grant (c. $80 m per annum, or 6% of total operational grant funding) - funding amount for each school was fixed in 2010 based on historic spend, with increases sought through the annual Budget process;
* a Vandalism grant (c. $8m per annum, or less than 1% of total operational grant funding) - based on risk profile of the school.

Schools do not need to spend these grants on prescribed activities, as the total operational grant is able to be spent at the board’s discretion. Schools are expected to cover other property-related costs, such as cleaning, lawn-mowing, caretaker wages and swimming pool chemicals from operational funding, but these are not part of an explicit component of the operational grant.

**Figure 1: Current state of funding for property-related activities: operational grant components**

Some property funding for property-related costs is centrally managed by the Ministry in order to leverage the size of the portfolio and/or limit the time schools need to spend on activities not directly related to teaching and learning. For example:

* Building Warrants of Fitness (BWoF) – the Ministry contracts with a supplier on behalf of schools who carries out BWoF compliance activities;
* School buildings insurance – the Ministry negotiates the insurance policy that covers Ministry-owned assets and pays the premium and excess;
* Vandalism top-up – if a school’s annual vandalism costs exceed a specified amount, it can apply to the Ministry for more funding that year;
* Lease payments to iwi for sites that have been transferred as part of a Treaty settlement – the Ministry pays these directly.

Aside from these centrally managed activities, the current funding mechanisms in this area revolve around the distribution of money and not the outcomes sought. This results in relatively simple, formulaic approaches (that tend to deviate from underlying cost drivers over time) but a limited understanding of what this quantum of funding actually buys.

Even where a school board has suitable asset management capability, there remain tensions between:

1. the opportunity cost of time spent on property matters — surveys[[1]](#footnote-1) have shown that New Zealand primary school and secondary school principals spend an average of 15% and 9% of their time on property management respectively. This is a large amount of a professional educator’s time being spent on a non-core activity that they are not trained to perform; and
2. the shorter term tenure of board members (3 years) and the long-term focus required for asset management (50+ years).

The management requirements of the built environment have changed dramatically since Tomorrow’s Schools was enacted in the late 1980s. There is now a greater amount of legislation involved that property owners and operators need to comply with or risk prosecution. Furthermore, new schools, or significantly redeveloped schools, require more proactive maintenance in order to protect the product warrantees and the taxpayer’s investment in these high value facilities.

In recent years, the Ministry has increased its capacity and capability regarding school property, reflecting:

1. the need for the Ministry to ensure adequate asset management of a substantial Crown asset; and
2. the variable capability and capacity of school boards of trustees to manage school property.

To date the focus has been on capital spending, as the operational spend regarding property is at the discretion of boards of trustees.

Given the Review is considering what happens to operational funding, it is timely to consider:

1. whether the current flexibility regarding operational funding distributed to boards should be limited to better enable boards and the Ministry to manage for desired outcomes; and
2. whether the current mix between funding distributed to boards and funding centrally managed by the Ministry is appropriate.

*Question for discussion:*

*While there is scope to improve funding arrangements in this area, what aspects of the current model for property-related funding would you like to see retained?*

Options Considered:

Funding arrangements for school property should reflect education and asset management drivers that apply to the portfolio.

The following critical success factors have been identified to guide a preliminary assessment of identified options:

1. frees up more school leadership time to focus on education – if the funding arrangements and delivery of related services are onerous for schools, this may negatively impact on educational outcomes;
2. improves value for money – delivers better asset management for the same level of investment or frees up money that would otherwise be spent on property for other education initiatives;
3. improves accountability for the use of funding – ensures everyone in the system knows the outcomes the funding is intended to achieve, and those with decision making authority are able to be held to account for these outcomes;
4. improves asset management decisions at a portfolio level – ensures funding is allocated to the areas of greatest need across the portfolio; and
5. straight-forward to implement and manage – the funding mechanism is not overly complex and, if the change process is carefully managed, is likely to be supported by the majority of the sector.

The key questions relate to whether:

1. the allocation approach for the various property-related components reflects the cost drivers; and
2. property-related funding currently within the operational grant should be separated from funding for teaching and learning and ‘ring-fenced’ (funding can only be spent on specified activities).

**Figure 2: Separation of property-related funding from funding for teaching and learning**

The ring-fencing could take a number of forms, with a single property-related funding pool, or multiple. As we work through the options, it may become clear that funding for some activities might be better left with per-child funding.

Removing the flexibility of schools to transfer funding between asset management and other operating activities would have the following benefits and costs:

|  |  |
| --- | --- |
| Benefits | Costs |
| Makes it simpler for schools to understand what is expected of them, and where funding should be allocated | Some schools may be opposed to the loss of flexibility over current quantum of operational funding |
| Enables more consistent asset management decisions | Any items separated from general operational funding and tagged to specific activities must be adequately funded to deliver the required outcomes |
| Provides Ministry greater levers to control cost pressures (e.g. better incentivises whole-of-life cost decision making) | Greater Ministry oversight and direction requires an increase in resourcing |
| Has the potential to free up more time for school leaders to focus on education |  |

The rest of this document steps through options for property maintenance, heat, light and water and vandalism in more detail.

Property Maintenance

At present, schools receive a property maintenance grant (PMG) as part of the operational grant. The PMG calculation for a school is based on:

1. gross area (the internal areas of a building including areas such as corridors, toilets, stairwells) of Ministry-owned or integrated buildings
2. square metres of painted surfaces
3. cubic capacity of the swimming pool
4. the ‘corrosion factor’ for schools in areas where buildings are subject to very high corrosion from extreme weather and salt spray (it provides a top-up for these schools to carry out the more frequent maintenance needed)
5. the ‘isolation factor’, which is linked to the isolation index used in operational funding (it is an adjustment for schools in isolated areas that have extra costs due to their remoteness).

Options considered:

We have done some preliminary exploration of three options for how the funding system might support property maintenance:

1. **Retaining the status quo** - continue to provide PMG based on current formula and as part of the operational grant.
2. **Developing a new formula** to better allocate the existing c. $90 million based on asset characteristics that are driving maintenance costs, and continue to provide this funding as part of the operational grant
3. **‘Ring-fence’ PMG** so that it must be spent on property maintenance activities and unspent funding is returned to the Ministry. Unspent funds used to reallocate to schools that need more maintenance support. Requires clearly specifying maintenance standards for boards and monitoring performance
4. **Centralise PMG funding** - rather than provide boards with PMG, schools receive the services in-kind. The Ministry would be responsible for arranging the services (like it does with Building Warrants of Fitness), possibly through regional facilities management contracts.

|  |  |  |
| --- | --- | --- |
| Option | *Advantages* | *Disadvantages* |
| Status quo | * Administratively simple * Provides high degree of flexibility for schools | * Lack of clarity about outcomes sought with the funding * Hasn’t led to consistently good asset management outcomes at schools * Lack of transparency over how money is spent on property, which makes it hard to assess if a school is being underfunded / seek increase in total quantum from Government as no guarantee additional investment will be spent on assets * Requires significant school leadership time to determine appropriate spend on property and manage related activities |
| New formula but PMG remains part of operational grant | * Administratively simple * Provides high degree of flexibility for schools * More clarity about outcomes sought | * Still focussed on funding flows rather than managing for outcomes * Lack of transparency over how money is spent on property, which makes it hard to assess if a school is being underfunded / seek increase in total quantum from Government as no guarantee additional investment will be spent on assets * Likely to diverge from actual costs overtime, requiring another review/reset in the future * Requires significant school leadership time to determine appropriate spend on property and manage related activities |
| Separate PMG from operational grant  [preferred option] | * Clarity about outcomes sought and accountabilities * Schools no longer asked to cross-subsidise maintenance from funding for teaching and learning * Limits ability of schools to underspend (based on allocation) on maintenance * More transparency over how money is spent on property, so the Ministry can:   + determine if individual schools require more funding   + make a case to increase total quantum of funding   + determine best interventions to help struggling schools, eg centralising element(s) that will make the biggest impact * Does not preclude Ministry setting up opt-in facilities management contracts, and makes it clearer how much funding schools should forgo if they opt-in. * Enables capital and operational funding for property to be more closely aligned to incentivise whole-of-life decision making | * Reduces flexibility of schools to allocate PMG to other areas of need * Changes incentives at school-level (eg spend total allocation even if not required) leading to cost escalation * Requires significant school leadership time to determine appropriate spend on property and manage related activities * Requires total PMG to be adequate to cover maintenance outcomes sought – risk of underfunding transferred to Ministry |
| Centralise funding | * Significantly reduces time school leaders need to spend on maintenance * Clarity about outcomes sought and accountabilities * Schools no longer asked to cross-subsidise maintenance from funding for teaching and learning * Limits ability of schools to underspend (based on allocation) on maintenance * More transparency over how money is spent on property, so the Ministry can make a case to increase total quantum of funding * Enables capital and operational funding for property to be more closely aligned to incentivise whole-of-life decision making | * Likely to cost more due to management component currently provided by schools that Ministry and private providers would have to take on * Removes flexibility of schools to allocate PMG to other areas of need * Changes incentives at school-level (eg won’t accept substandard condition that they may have under status quo) leading to cost escalation * Limited value for schools with existing property teams (eg larger secondary schools) * Requires total property maintenance funding Ministry receives to be adequate to cover maintenance outcomes sought – significant risk of cost escalation for Crown |

Preliminary conclusion and issues for consideration

At this point, based on the information to hand, the preferred option is separating PMG from the operational grant.

The following key steps are required to assess this further, which may address some of the disadvantages noted above:

1. Better understand how schools currently use PMG allocations
2. Better define outcomes sought from property maintenance and determine how this will be measured and monitored
3. Assess whether any elements will be centrally provided rather than funded in cash (see discussion below) to reduce time school leaders spend on maintenance
4. Assess quantum of PMG to be ring-fenced (could be more or less than current allocation if a different amount can be evidenced and tied back to outcomes sought)
5. Design mechanism for ‘ring-fencing’. May include move between appropriations (eg move funding to Property Portfolio Management appropriation and make the Ministry’s Education Infrastructure Service responsible for its payment and monitoring).

Centralisation has already been signalled as a possibility, on an opt-in basis, through facilities management contracts (Ministers’ 2013 8 Point Plan; pilot undertaken in 2014), and is the approach taken for public private partnerships. These examples provide a limited data set from which some preliminary assessments can be made[[2]](#footnote-2). However, full service facilities management is only one option for centralising property maintenance funding. As with Building Warrants of Fitness, there may be other discrete activities that could be centrally managed on behalf of schools. For example, Victoria in Australia has recently introduced a central gutter cleaning contract to reduce the number of drainage and roofing issues at schools and reduce the time spent by schools on this particular activity. More information, and more work, is required to identify and assess the options for which services could be centralised.

Utilities

The Ministry currently has a very limited data set on the actual cost of utilities for specific schools, or the scope for savings that could be realised through smarter procurement and energy efficiency measures. This is, in part, a symptom of the current funding approach, which is administratively simple and contains some incentives for schools to reduce costs, but the Ministry is not resourced, or incentivised, to drive further efficiencies.

Heat, Light and Water funding is currently provided to boards of trustees as part of operational grants. This component is intended to cover:

1. electricity — supply, capacity and line charges;
2. gas, reticulated and portable, including delivery and canister hire;
3. coal and wood, including delivery costs; and
4. water supply rates.

In the past, schools were funded for actual heat, light and water use. In 2010, funding levels were fixed in order to incentivise schools to reduce heat, light and water consumption to create savings that can be realised and applied by the school to other purposes. Funding levels have since been increased by small increments as negotiated through the annual Budget process.

Analysis of audited annual accounts provides data up to the end of 2014. This suggests that approximately one third of schools are spending less than their Heat, Light and Water funding allocation, and two thirds of schools are spending more. We are unable to comment on the appropriateness of this split as we are currently investigating issues with what is included in heat, light and water in schools’ audited accounts, and don’t know the level of out-of-hours / third party use going on in schools that are spending more than their allocation.

**Options for the funding and management of utilities:**

We have explored three options for how the funding system might support property maintenance:

1. **Retaining the status quo** - current funding arrangements remain and the Ministry continues to encourage schools to use all of government contracts and consider the whole-of-life costs of energy systems (boilers, heat-pumps, etc) used in schools.
2. **Developing a new formula** to better allocate the existing c. $80 million based on factors that drive utilities cost (eg asset characteristics, roll size), but the funding remains part of the operational grant and is not ring-fenced.
3. **‘Ring-fence’ Heat, Light and Water funding** so that it must be spent on utilities costs. Provide existing allocation to schools. Those that overspend will be topped up. Those that underspend will get to keep a share (eg 50%) of the underspend for allocation to different activities, with the remainder returned to the Ministry for reallocation (covering overspends and investing in efficiency measures).

|  |  |  |
| --- | --- | --- |
| Option | *Advantages* | *Disadvantages* |
| Status quo | * Administratively simple * Schools are incentivised to reduce expenditure on utilities to free up funding for other activities | * Approximately two-thirds of schools are currently cross-subsidising the payment of utilities from other activities, demonstrating:   + some schools cannot afford capital investments to reduce utilities consumption (eg install LED lights, Building Management Systems, alternative energy sources)   + schools are generally price takes on the energy market; and/or   + current incentives aren’t strong enough for some schools to justify the management effort to reduce costs * No linkage between utilities funding and capital investment means the Ministry, and to an extent schools, are not incentivised to minimise whole of life costs * Ministry has limit information on usage or spend, which makes it hard to assess if a school is being underfunded / seek increase in total quantum from the Government * Ministry not resourced to work with other agencies and energy firms to garner existing support for sustainability measures and direct it to the areas of greatest gain for schools and the portfolio. |
| New formula | * Administratively simple * May lead to funding and spend being more closely aligned, at least initially | * Still focussed on funding flows rather than managing for outcomes - will not minimise whole-of-life or whole-of-system costs. * Will create a new set of winners and losers, rather than create conditions for improvement at the portfolio level * Likely to diverge from actual costs overtime, requiring another review/reset in the future * No linkage between utilities funding and capital investment means the Ministry, and to an extent schools, are not incentivised to minimise whole-of-life costs * Without continuous data collection, the Ministry would have limited information on usage or spend, which makes it hard to assess if a school is being underfunded / seek increase in total quantum from Government * Ministry not resourced to work with other agencies and energy firms to garner existing support for sustainability measures and direct it to the areas of greatest gain for schools and the portfolio |
| Ring-fencing funding  [preferred option] | * Schools no longer asked to cross-subsidise utilities costs from funding for teaching and learning * Funding freed up to reinvest in energy efficiency measures at schools, to drive further savings * Ministry taking a more active role in the market and in sharing good practice reduces management burden for schools * More transparency over how money is spent on utilities, so the Ministry can:   + determine if individual schools require more funding   + make a case to increase total quantum of funding   + determine best interventions to help struggling schools * Enables capital and operational funding to be more closely aligned to incentivise whole-of-life decision making | * Reduces flexibility of schools currently underspending (approx 1 in 3) to allocate Heat, Light and Water funding to other areas of need * Changed incentives at school-level could lead to cost escalation if not carefully calibrated and monitored * Requires total Heat, Light and Water funding to be adequate to cover actual spend - risk of underfunding transferred to Ministry. * Requires more resourcing for the Ministry – additional cost needs to be justified by reduced cost pressures at portfolio level and benefits to schools. |

Preliminary conclusion and issues for consideration

At this point, based on the information to hand, the preferred option is separating funding for utilities from the operational grant.

The total quantum of funding would need to be sufficient to cover actual costs (we are working on getting the evidence base to quantify this). Ministry would need to be resourced to track usage and spend, provide support to schools that need it, help schools get onto All-of-Government supply contracts or negotiate alternatives, and make smart investment decisions to drive efficiency at the portfolio level. In time and with the necessary resources, it could be more proactive, including negotiating directly with local authorities on pan taxes and other water/sewerage levies proposed for introduction.

*Question for discussion:*

*How might out-of-hours use (eg hiring out the use of a school’s hall) be factored into funding allocations?*

Vandalism

In the [Property Occupancy Document](http://www.education.govt.nz/school/property/state-schools/property-occupancy-document/), vandalism is defined as “wilful damage to or loss of any part of the school site, buildings or other facilities, excluding arson and normal wear and tear”.

Each year schools receive funding to manage vandalism as part of their operational grant. This is a separate line item in a school’s grant notice. The amount depends on which vandalism risk category the school is in. The risk category is based on the average vandalism costs for the school in the past. If a school spends more than the upper limit of its risk category, it can apply to the Ministry for a Vandalism top-up.

**Options for vandalism funding:**

1. Status quo:

Continue to provide some funding for vandalism as part of the resourcing for teaching and learning, and have a top-up mechanism for schools with excessive vandalism expenses.

1. Cashed up:   
   All vandalism funding is part of resourcing for teaching and learning (per pupil funding). This would see the vandalism top-up removed and reduce the need for schools record vandalism against Ministry-owned buildings separately. However, it would make it difficult for schools to manage in years in which they have excessive vandalism costs.
2. With property maintenance funding (ring-fenced):  
   This would reduce the ability of schools to use underspends for other purposes, but also reduces the ability of schools to quickly respond to minor vandalism events without the need to engage with the Ministry. This approach may provide a greater incentive for the Ministry to invest in security measures that reduce total spend on vandalism – although schools will still have a significant influence on the behaviour of those entering their sites.

Preliminary conclusion

The option taken for vandalism will be influenced by whether PMG and Heat, Light and Water funding are ring-fenced. Based on current information, we recommend including vandalism funding in the ring-fenced amount for property related costs if ring-fencing is progressed, as it makes sense to have vandalism funding closely linked with property maintenance funding.

Other property-related costs

There are other expenses that schools incur which are related to school property and are funded out of the operational grant, but are not factored into the funding for PMG, Heat Light and Water or Vandalism Grant components. Such expenses, which the Ministry expects schools to pay for from per pupil or base components, include:

* + cleaning
  + rubbish disposal
  + pool chemicals (or transport to a community pool)
  + caretaker’s wages
  + lawn-mowing
  + pest control

It is possible that some of these tasks/costs can be rolled into the ring-fenced amount for property maintenance, though more work will be required to understand what schools currently spend on these activities and define what good looks like.

To date the Ministry’s focus has been on gathering data about property maintenance and utilities, as together these help ensure school buildings are safe and inspiring, and the internal environment is warm and well-lit to minimise distractions for learners. Core maintenance activities are also more closely related to preserving the value of these Crown assets and reducing the need for costly capital interventions.

Some schools have indicated they would like to pass responsibility to the Ministry for as large a proportion of property-related activities as possible. It is possible that a facilities management contract could be ‘full service’, or for a contractor to offer a menu of additional services that schools can opt to receive. These add-ons could either be:

1. at the school’s cost based on the actual cost from the facilities management contractor (works best if the add-ons are part of the cashed-up funding)
2. funded (in-part or wholly) by removing a component of funding from the school.

Preliminary conclusion

Option b) would work best if every element of facilities management was an itemised element of the funding formula. However, this is not the current approach, nor does it align with the more streamlined direction of funding systems signalled by the Minister.

As such, we recommend that these other elements of property-related funding remain part of operational funding, at least for the time being.

Conclusion

Based on current information, we can see benefit in progressing ring-fencing property maintenance, utilities and vandalism. This could:

1. provide greater clarity about the level of investment in property relative to teaching learning
2. support the Ministry to better guide and support schools to make efficient decisions, through a clearer understanding of their property-related expenditure, leading to more time for school leaders to focus on teaching and learning
3. better align capital and operational funding related to property to incentivise whole of life cost decision making
4. better support the Ministry to manage the risk to the Crown’s investment in school property.

*Questions for discussion:*

*If ring-fencing is progressed, would you support a staged approach (eg beginning with Heat, Light and Water and then bringing more funding across into the infrastructure funding stream) or minimising the number of changes to funding allocations?*

*How will this all work for Communities of Learning (CoLs)?*

*\* pooling funding?*

*\* CoL-based contracts for goods and services?*

*Does separating property-related funding from funding for teaching and learning make sense for state-integrated schools, given the Crown’s different ownership interest in the assets?*

1. TIMSS — Trends in International Mathematics and Science Study and PIRLS — Progress in International Reading Literacy Study. [↑](#footnote-ref-1)
2. Findings to date indicate that smaller schools and recently opened new schools tend to favour handing over facilities management responsibilities, while larger, established schools see less value in it. Due to the coarseness of the current PMG calculation, it is also difficult to compare a market price with what the Ministry should be prepared to pay for property maintenance at a specific school. [↑](#footnote-ref-2)