MINISTRY OF EDUCATION
TE TĀHUHU O TE MĀTAURANGA

Education Report: Early learning pay parity – impacts of opt-in rates

To:	Hon Chris Hipkins, Minister of Education		
Date:	13 April 2021	**Priority:**	Medium
Security Level:	Budget Sensitive	**METIS No:**	1255414
Drafter:	Graham Bussell	**DDI:**	463 2385
Key Contact:	John Brooker	**DDI:**	9(2)(a) [redacted]
Messaging seen by Communications team:	No	**Round Robin:**	No

Purpose of Report

This paper provides you with information on impacts to education and care services of opting into the higher funding rate to be offered as part of the Budget 2021 pay parity initiative. The paper follows discussion at the Agency meeting on 22 March 2021.

Summary

1. Although you have asked for specific examples of the impact of a service opting into higher funding rates in exchange for paying kindergarten teacher rates, the Ministry does not hold sufficient sector information to do this.

2. Instead, we have created a model that draws on sector data we do hold to simulate the impact on a service with given characteristics. This model confirms the following impacts from opting in are possible.

    - Additional subsidy revenue can be greater than the additional cost of required pay steps, so a service is actually financially better off opting in.
    - Additional subsidy revenue can be equal to the additional cost of required pay steps.
    - Additional subsidy revenue can be less than the additional cost of required pay steps meaning services would need to find extra funding from other sources.
    - Opting in could result in a breakeven position or better in one year but be unsustainable in subsequent years as teachers move up a pay step but funding rates remain the same.
    - Service ownership type could be a factor as to how well a service can meet opt in costs, regardless of higher funding rate income. Differences in rent levels between service ownership types are used to illustrate this.
    - Unmet salary costs could be met by increases to parental fees, although the model suggests the increases required would not be substantial.

3. The key unknown is how much financial ‘headroom’ services already have to meet required pay steps, regardless of the higher rates. The rent scenario shows one example of how headroom could occur. The cost adjustment funding in Budget 21 is another source of headroom.

4. The results of this analysis confirm that the current funding mechanism does not evenly allocate pay parity funding across services. This suggests that a more targeted mechanism would be helpful. 9(2)(f)(iv) [redacted]

Recommendations

The Ministry of Education recommends you:

a. **discuss** with officials the funding system options outlined in paragraphs 28-31

b. **agree** that this Education Report is not proactively released at this time because of Budget sensitivity.

Release / Not release

John Brooker
Group Manager
Education System Policy

16 / 04 / 2021

Hon Chris Hipkins
Minister of Education

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Background

1. Budget 2021 will provide funding for a pay parity initiative that allows education and care services to opt-in to a set of higher funding rates, if they agree to pay certificated teachers with designated experience at set salary levels. The experience and salaries required reflect the first six of eleven pay steps in the current Kindergarten Teachers, Heat Teachers, and Senior Teachers' Collective Agreement ("the KTCA").

2. On 8 March 2021, we provided a report that outlined how this opt-in funding approach risks an uneven and incomplete take-up by services [METIS 1250399 refers]. The downstream impact of this is that not all teachers who would be eligible to receive a payrise would receive one.

3. We noted an associated risk that opt-in funding might not be spent only on salaries, even if teachers are paid at the required steps. This is because it is impossible to track new funding once it is incorporated into 'bulk' ECE grants.

4. In the March paper, we suggested that successfully achieving pay parity for all teachers required reworking the mechanism underpinning ECE subsidies.

5. On 22 March 2021, during consideration of the paper at the Agency meeting, you indicated comfort with the approach outlined in the Budget initiative, although recognising that it was a coarse approach to achieving pay parity. You suggested that services would largely accept the opt-in rates offered. However, you also asked for examples of real services' circumstances to show the implications of accepting the opt-in rates. This report responds to that request.

Impact on services of opting into higher funding rates

6. The Ministry is unable to directly answer your request because it does not hold sufficient and up-to-date financial and staffing data to provide examples of likely impacts on real education and care services. We would need the following information for each service to identify actual impacts:

   - a breakdown for each service of its certificated teachers' pay rates and associated years of relevant work experience and qualifications.
   - parent fee schedules and fee revenue received by all education and care services.
   - detailed breakdown of each service's across-the-board expenses.

7. Instead, we present figures generated by a model the Ministry has created that calculates changes to government revenue and teacher pay costs for specific service profiles after opt-in to the higher rates. Because we are only simulating these scenarios, it does not estimate the proportion of actual services that would fall into each profile.[1] The core scenarios described are where:

   - Additional subsidy revenue from opting into higher rates is *greater* than the additional cost of required pay steps.
   - Additional subsidy revenue from opting into higher rates is *equal* to the additional cost of required pay steps.

[1] Besides not reflecting actual services, the averaged data used in the model is limited by services submitting only partial financial statements or not needing to send audited financial reports where total Ministry income is $80,000 or less.

- Additional subsidy revenue from opting into higher rates is *less* than the additional cost of required pay steps.

8. Besides these scenarios, we also outline several other situations, which could influence a service's decision to opt in. These are:

    - The additional salary cost for teachers moving up a pay step after an additional year of service. We use this to show that opting in could be attractive now but be unsustainable in future years.
    - The effect that expenses other than salary may have on services' ability to opt in. We use differences in average rent levels between service ownership models as an example.
    - The impact salary costs could have on parental fees. We use the model to explain how much parent fees would rise if this was used to meet any shortfall in salary cost.

About the service

9. We have used consistent service characteristics across scenarios to isolate the impact of changes in expense and revenue. The characteristics are:

    - A centre with 60 licensed child places.
    - The 60 places split into 20 under 2 year olds and 40 2 year olds and over.
    - Attendance per week for that size service is based on a sample of a year of pre-Covid-19 attendance (Feb 2019 to Feb 2020) for each age band and the average mix of funded/unfunded child hours in that year.
    - Application of the minimum adult: child regulated ratios – essentially 1:5 for under 2 year olds and 1:10 for 2 year olds and above.
    - 85% of staff FTE is provided by certificated teachers and 15% by unqualified staff. This equates to 4 FTE of certificated teachers (the model rounds part FTEs up, which partly corrects for the limitation of using the minimum ratio staffing.[2]
    - Non-contact time is drawn from 2020 ECE Census data.
    - The change in funding rates is from the base rate at 1 Jan 2022 to the higher opt-in rates available at the same date.

10. The key parameter that is varied in each scenario is the experience 'mix' of qualified teachers – the length of relevant work experience. As mentioned earlier, we also differentiate average rent costs by ownership model (private versus community-based).

11. We have also made assumptions about average salaries for teachers with specific years of relevant experience. The Remuneration Survey provides an indication of where these lie. However, we have adjusted these figures because the Remuneration Survey did not break down salaries for each year of experience. The adjusted figures are likely to differ slightly from actual salaries, although this will not be material to the analysis.

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[2] Minimum ratio staffing is typically less than a service needs, for example, because of the need to cover mandatory breaks. This has been used as a proxy to produce estimates of FTE for a service, however, it likely underestimates the salary costs of services.

Scenario by scenario analysis

Scenario 1: New revenue exceeds additional salary cost

Certificated teacher composition

Years' experience (Pay step)	FTE	Existing salary	Opt-in salary
2	1	$ 52,000	$ 53,544
3	1	$ 52,144	$ 55,948
4	1	$ 53,144	$ 58,133
5	1	$ 54,144	$ 61,794

12. In this scenario, the service faces an additional salary cost of $17,987 per year. The additional revenue from opting in is $26,678. This means the service is $8,691 better off following opt-in. While all its certificated teachers receive a pay increase due to being under the opt-in pay steps, the increased expense associated with each FTE is small. We would expect this service to opt into the higher rates as, among other things, it provides a windfall gain.

Scenario 2: Revenue equal to additional salary costs

Certificated teacher composition

Years' experience (Pay step)	FTE	Existing salary	Opt-in salary
3	1	$ 52,144	$ 55,948
4	1	$ 53,144	$ 58,133
5	1	$ 54,144	$ 61,794
6	1	$ 55,144	$ 65,776

13. In this scenario, the service faces an additional salary cost of $27,075 per year. Compared to Scenario 1, the FTE distribution is one pay step higher for each FTE. The additional revenue from opting in is, again, $26,678. This produces a very small shortfall of $397, effectively breakeven for the purposes of this analysis. A service would consider opt-in in this scenario.

Scenario 3: Revenue less than additional salary costs

Certificated teacher composition

Years' experience (Pay step)	FTE	Existing salary	Opt-in salary
3	1	$ 52,144	$ 55,948
5	1	$ 54,144	$ 61,794
7	2	$ 56,018	$ 65,776

14. In this scenario, the service faces an additional salary cost of $30,971 per year. Compared to the other scenarios, the FTE distribution is skewed towards higher experience. This creates a higher cost because the pay gap for teachers with seven years' experience is markedly higher than for teachers on lower steps. The additional revenue from opting in is, again, $26,678. This means the service faces a $4,293 shortfall. This service would need to source additional funding to realistically opt-in. This may involve raising fees or reducing costs elsewhere in its operation.

Scenario 4: Pay step movement across years

Certificated teacher composition

Years' experience (Pay step)	FTE Year 1	FTE Year 2	Existing salary	Opt-in salary
3	1		$ 52,144	$ 55,948
4	1	1	$ 53,144	$ 58,133
5	1	1	$ 54,144	$ 61,794
6	1	1	$ 55,144	$ 65,776
7		1	$ 56,018	$ 65,776

15. Service owners need to consider the impact of upward pay movement across years. This alters the breakeven point. This is demonstrated with the FTE distribution in Scenario 4. The service is breaking even in Year 1 (as for Scenario 2 earlier). In Year 2 with the same staff, the FTE mix moves up a pay step due to each teacher having another year of relevant teaching experience. This leads to an increase in net deficit from $397 to $6,351 in the second year.

Scenario 5: Significant differences in non-salary expenses impact

16. While the sector data we have is too limited to understand each service's capacity to opt in, the Ministry's sampling of community-based (ie, not-for-profit) and private (ie, for profit) service financial statements has allowed us to discern a significant difference in rents between the two ownership structures.[3] This difference suggests some services may have more financial headroom to offer higher pay than others.

17. For services with between 44 and 62 licensed places, private providers paid an average of $90,900 per year in rent. For community-based providers, the equivalent figure was just $7,900. This reflects that community-based services are more likely to own their building outright or operate under a peppercorn lease arrangement (eg, with a council or government department) than private services.

18. While this may imply community-based providers have more scope to meet shortfalls in funding upon opting in, we cannot rule out that community-based providers may already be using the lower average rent to pay staff at higher rates. In this case the opt-in rates would present windfall gain to community-based providers. Alternatively, they may be channelling this funding into lower per child fees or greater spending on maintenance. In this case the opt-in rates may cause centres to increase fees to cover any shortfall from funding. We do not have the data to confirm which approach is most common.

Scenario 6: Potential impact on child fees to meet opt-in costs

19. Our understanding of the level and structuring of fees charged to parents is limited. Regardless of this, the Ministry's model allows us to provide simplified estimates of the change in fees that might be contemplated by services if they choose to use this to make up any shortfall.

20. The shortfall of $4,293 in Scenario 3 would equate to an extra 14 cents per hour on all child hours, excluding 20 Hours ECE, for which fees are not allowed to be charged.

[3] We note that complete financial statements from private providers are now very rarely submitted to the Ministry (which is within Ministry funding requirements). This has limited the available sample for these providers, which creates additional uncertainty about the average rent costs used in the model.

21. This level of shortfall would not necessarily be insurmountable for services and parents. In practice it would equate to an increase of no more than 1-2 dollars per week for each parent. Larger deficits would increase this, although these are still unlikely to be more than ten dollars per week per parent.

Cost adjustment impact

22. Budget 21 will also deliver a 1.2% increase in ECE subsidy funding. In a Budget sense this is distinct from the funding provided in the pay parity initiative. However, in the context of the teacher pay, the two initiatives overlap. This is because the universal nature of the cost adjustment means that at least some of it is intended to provide an increase to teacher salaries. If so, then the movement towards set pay steps could be aided by the cost adjustment.

23. This means that shortfalls of parity funding could be eliminated by use of cost adjustment funding. The shortfall of $4,293 in Scenario 3 could, for example, be reasonably met from some of the $13,339 additional cost adjustment funding that the service would receive in the same year. This seems reasonable when we understand typically between 70-80% of service costs are from salaries.

Consideration of alternative funding options

24. The examples presented above show there are situations where a service could rationally decide not opting in makes most financial sense. Conversely, it shows that services who have favourable cost structures would opt in despite not necessarily needing the funding. It also shows that cost adjustment funding provides a 'wildcard' that would allow more services to opt-in than would otherwise be possible.

25. This notwithstanding, the current mechanism is poorly targeted at distributing salary funding and creates uncertainty. Thus, shortfalls are possible despite the full cost of the initiative being estimated for the education and care subsector. This is the basis of our suggestion to revise the funding mechanism – while we can broadly estimate total cost of pay parity, the system cannot distribute it equitably to each service to target the increases in actual salary cost needed.

26. Furthermore, services might reasonably be expected to find additional income to opt in and increase their teachers' salaries. This is because ECE is only partially funded by government, which suggests increases to parental fees could be expected in order to achieve pay parity. The difficulty is that fee increases would be required on a random basis – the allocation of teacher experience in each service.

Ability of existing funding to meet new staff costs

27. A significant unknown is how well existing funding matches services' financial needs. We are unsure how many services have enough headroom to pay higher rates, particularly when we consider the shortfalls presented are likely to be underestimated.

28. The uncertainty includes the adequacy of Ministry subsidies. We understand these subsidies were set generously in the past, even though the ECE Subsidy was, and is, only intended as a partial subsidy. If it is still relatively generous, then more providers may be able to afford higher salaries than expected. Without more comprehensive financial and staffing data, we cannot establish if this is true.

Future funding mechanisms

29. In our earlier briefing we proposed reporting back on an approach to reworking the funding system. At this stage, we consider this is best done when we have clear direction that you want us to remodel the funding system.

9(2)(f)(iv)

[redacted]

[redacted]

Proactive Release

33. We recommend that this briefing is not released at this time because release at this stage would interfere with maintaining necessary confidentiality of the advice tendered by officials.