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Issues paper

This report is for information

This report provides an overview on the financial health of the higher education sector in England. The analysis covers the 2009-10 financial results and 2010-11 budgets, as submitted to HEFCE in early December 2010.

Financial health of the higher education sector

2009-10 financial results and 2010-11 forecasts

HIGHER EDUCATION FUNDING COUNCIL FOR ENGLAND

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2009-10 financial results and 2010-11 forecasts

To	Heads of HEFCE-funded higher education institutions
Of interest to those responsible for	Audit, Estates, Finance, Governance, Management, Planning
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Executive summary

Purpose

1. This report provides an overview on the financial health of the higher education sector in England. The analysis covers the 2009-10 financial results and 2010-11 budgets, as submitted to HEFCE in early December 2010. The report is being published to provide universities and higher education colleges with feedback on their financial performance in 2009-10 and original estimates for 2010-11 before they submit their updated financial forecasts in April 2011 (as requested in HEFCE Circular letter 07/2011). The analysis also provides stakeholders with information about the current financial health of the sector.

Key points

2. Higher education institutions (HEIs) in England are required to send us their annual accountability returns in December each year. These returns form a significant part of the way in which HEIs can demonstrate accountability for the public funds distributed to them. The accountability returns enable HEFCE to reassess HEIs' overall risk assessments and to ensure that HEIs are meeting their accountability responsibilities.

3. Due to the uncertainty over the future funding climate, we gave institutions an option to defer forecast information for the period 2011-12 to 2013-14 until April 2011 (see HEFCE Circular letter 27/2010). Eighty-five institutions decided to defer submission until that time.

4. All institutions were required to provide their financial results for 2009-10 and their budget position for 2010-11. It should be noted that the 2010-11 figures were submitted to HEFCE before further reductions in the HEFCE funding for 2010-11 were confirmed by the HEFCE Board in January 2011.

5. The overall financial results for the sector in 2009-10 show a stronger financial position than previous years. On a number of key indicators the financial results are the best on record. At the end of 2009-10 the sector had strong cash balances and healthy reserve levels, which will

provide some cushion for the likely risks the sector now faces. There is also evidence that many institutions have taken the opportunity to restructure their cost bases ahead of the pressures on public funding.

6. The projected performance in 2010-11 is sound overall, albeit not as strong as 2009-10. Cash levels are expected to remain strong, which is important as the sector enters a potentially difficult year in 2011-12. However, as already noted, the 2010-11 projections were made before further reductions to HEFCE funding were announced in January 2011.

7. We will publish an update on the financial health of the sector when we have received and analysed all HEIs' financial forecasts for the period 2011-12 to 2013-14.

Action required

8. No action is required: this report is for information.

Headline information

9. Table 1 provides a summary of the key financial results for 2009-10 and shows the forecast performance in 2010-11.

Table 1 Summary of key financial indicators

	Actual		Forecast
	2008-09*	**2009-10**	**2010-11**
Total income	£21,015M	£22,215M	£22,729M
Operating surplus as % of total income	£275M 1.3%	£716M 3.2%	£402M 1.8%
Historical cost surplus as % of total income	£522M 2.5%	£804M 3.6%	£542M 2.4%
Cash flow from operating activities as % of total income	6.8%	8.2%	4.4%
Net liquidity as no. days' expenditure	83	98	80
External borrowings as % of total income	20.9%	21.1%	22.4%
Discretionary reserves exc. FRS 17, as % of total income	43.7%	46.1%	48.2%

* Data from the 2008-09 HESA Finance Statistics Return.

Financial performance

10. The overall financial results for the sector in 2009-10 show a healthy position. However, as in previous years, the sector-wide picture encompasses a wide range of results between institutions. The key messages from the analysis into the 2009-10 annual accounts are included in the following section.

Income and expenditure

11. Total income was £22,215 million, which was an increase of 5.7 per cent on the previous year. The main reason for the increase in 2009-10 was the significant rise in income from tuition fees (across all areas). Excluding the rise in tuition fees, all other income (on average) only increased by inflation. Table 2 provides a breakdown of fee income.

Table 2 Breakdown of tuition fee income

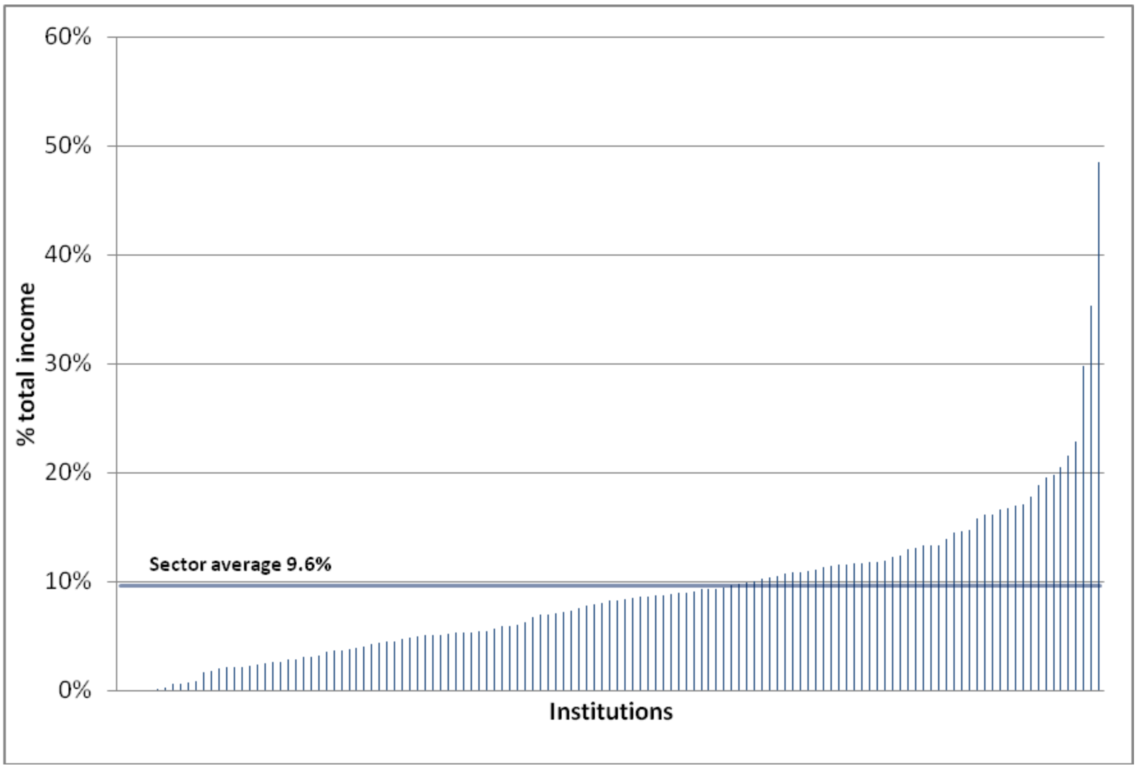
	2008-09	**2009-10**	**% increase**
FT UG (home & EU)	£2,358M	£2,704M	14.7%
FT PG (home & EU)	£482M	£553M	14.7%
PT (home & EU)	£495M	£526M	6.4%
Health (home & EU)	£659M	£705M	6.9%
Overseas	£1,811M	£2,133M	17.8%
Other	£473M	£506M	7.0%
Total fee income	**£6,278M**	**£7,127M**	**13.5%**

Note: FT – full-time; PT – part-time; UG– undergraduate; PG – postgraduate.

12. Table 2 shows that there has continued to be considerable growth in fee income from overseas students. Over the past 10 years this income stream has more than doubled in real terms and at the end of 2009-10 this income accounted for 9.6 per cent of the sector's total income, the highest on record.

13. However the dependence on this income source still varies between institutions, ranging from 0 per cent to 48.5 per cent of total income. The 20 institutions recording the most income from overseas fees account for nearly 50 per cent of the sector's total, indicating that although almost all institutions receive income, the majority goes to a small group of institutions in London and the South East. Figure 1 shows the distribution last year.

Figure 1 Overseas fee income as percentage of total income (2009-10)



14. Despite the increase in total income during 2009-10, across the sector 20 HEIs recorded real-terms reductions in income compared to 2008-09, with 11 of these recording actual cash reductions in income. These 11 HEIs tend to be small and specialist institutions. At the same time though, another 20 HEIs recorded cash increases in total income of over 10 per cent. This indicates the wide variation in performance across the sector.

15. Staff costs remained the main contributor to expenditure, although as a proportion of total income the level of staff costs reduced to 54.3 per cent (55.4 per cent in 2008-09). In total absolute terms, staff costs increased by 3.5 per cent during the year, a much lower increase than previous years. Within this increase, pension costs (employers' contributions) grew by 13.3 per cent.

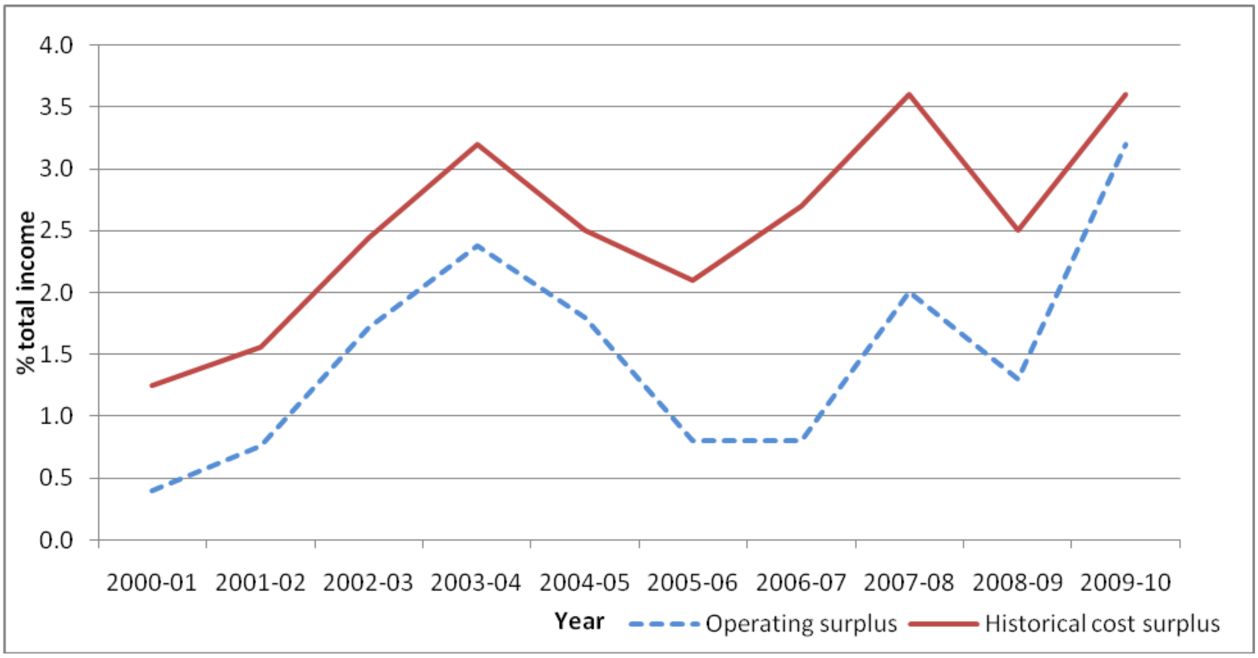
Surpluses

16. The sector had an operating surplus (that is, total income less total expenditure before any exceptional items) of £716 million (3.2 per cent of total income). This is significantly better than any previous year on record (1994-95 onwards).

17. On a historical cost basis[1] the sector recorded a surplus of £804 million (3.6 per cent of total income), which is significantly ahead of the average over the past 10 years (2.6 per cent). The proportionately small difference between the operating and historical position in 2009-10 is partly accounted for by exceptional costs (for example profit or loss from the sale of properties or exceptional restructuring) of £69 million. This is the first year that the exceptional items line has been negative, which reflects the large amount of restructuring costs being accounted for in the year. In previous years the exceptional item line has been dominated by profits from the sale of assets.

18. Figure 2 shows the level of operating and historical cost surpluses since 2000-01.

Figure 2 Operating and historical cost surpluses as percentage of total income



[1] Historical cost surplus/(deficit) is after adjustment for the difference between historical cost depreciation and the actual depreciation charged on revalued assets, and net gains realised on the disposal of revalued assets. Institutions may use either historical cost or revaluation to value their assets and the different bases of valuation will alter the operating results, so the historical cost surplus/(deficit) provides greater consistency for comparison of results between institutions.

Liquidity[2] and borrowings

19. At the end of 2009-10 the sector had net liquidity of £5,435 million, equivalent to 98 days' expenditure. This is substantially above the forecast level (68 days), which probably reflects the better than forecast operating performance but could also indicate a more prudent approach to cash reserves. Only five institutions had liquidity of less than 10 days.

20. As in the previous two years the improved liquidity happened at the same time as an increase in borrowings. However the increase in borrowings was more marginal, from £4,397 million to £4,682 million. At the end of July 2010 the sector also had another £1,370 million of financing agreed with lenders but not drawn down. Between August and October the sector drew down £79 million of this borrowing.

21. Borrowing now represents 21.1 per cent of income, marginally up on the previous year. However in 2009-10 interest payments increased significantly (by 17.5 per cent). Despite this the sector's annualised servicing costs have also remained fairly constant, being 2.11 per cent of income in 2009-10 (compared with 2.13 per cent in 2008-09).

Reserves

22. Discretionary reserves[3] at the end of 2009-10 totalled £6,942 million, after taking into account the impact of the financial reporting standard on retirement benefits (FRS 17). This reporting standard, which requires pension scheme surpluses or deficits to be included in the balance sheet (but not those of the Universities Superannuation Scheme), makes comparisons with previous years more difficult. Without FRS 17 the sector would have reserves of £10,249 million, equivalent to 46.1 per cent of total income. Total pension scheme deficits of £3,307 million reduced reserves to 31.3 per cent of income. The level of pension scheme deficits decreased by £321 million this year, mainly due to changes in the inflation assumptions from Retail Price Index to Consumer Price Index.

23. As reported in previous years, the aggregate sector financial position masks a significant spread of financial strength, with a concentration of large discretionary reserves in a small number of universities. Figure 3 shows the spread of reserves (excluding FRS 17) as a percentage of total income, as reported as at 31 July 2010.

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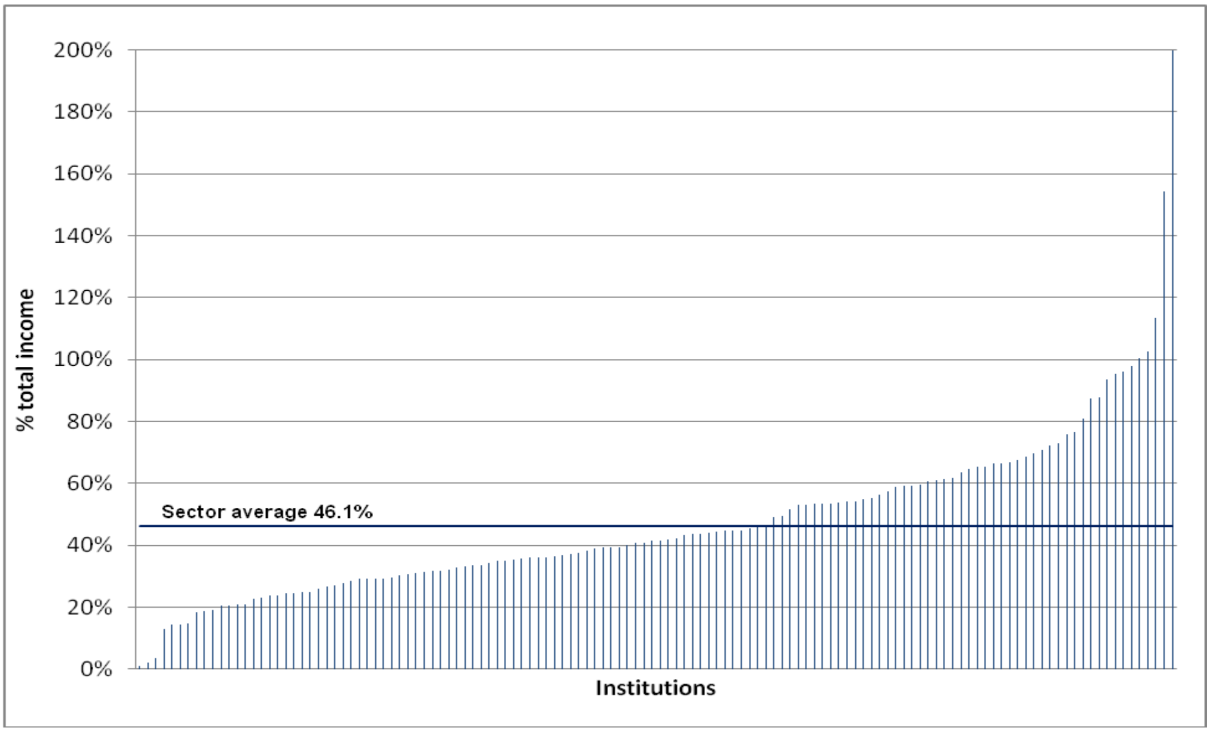
[2] Net liquidity = current asset investments plus bank and cash balances less bank overdrafts. The indicator is also expressed as the number of days' operating expenditure covered by the net liquidity.

[3] Discretionary reserves = expendable endowments plus general reserves from the balance sheet.

Figure 3 Discretionary reserves as percentage of total income (2009-10)



Cash flow

24. Cash flow from operating activities totalled £1,826 million in 2009-10, which compares favourably with the forecast of £778 million and the cash flow in 2008-09 of £1,429 million. The level of cash flow in 2009-10 was equivalent to 8.2 per cent of total income, an improvement on the 6.8 per cent in 2008-09. The sector has been increasing its cash flow gradually each year since 2004-05, which is a positive indicator of solvency.

Financial forecast for 2010-11

25. The overall projected results for 2010-11 for the sector look reasonable, albeit not as strong as 2009-10. In broad terms the 2010-11 year is similar to the outturn in 2008-09 and implies that the sector will be in a healthy position despite some reductions to public funding streams in that year.

Income and expenditure

26. Total income is forecast to increase to £22,729 million in 2010-11, which equates to an increase of just 2.3 per cent. This is significantly below the increase achieved in the last five years (8.1 per cent). Table 3 provides a breakdown of the income levels forecast.

Table 3 Breakdown of income levels

£ Millions	2008-09* Actual	2009-10 Actual	2010-11 Forecast	*% annual change between 2009-10 and 2010-11*
Funding council grants	7,098	7,278	7,183	*-1.3%*
Overseas fee income	1,811	2,133	2,335	*+9.5%*
Other academic fees and support grants	4,467	4,995	5,229	*+4.7%*
Research grants & contracts	3,334	3,500	3,616	*+3.3%*
Other operating income	4,002	4,131	4,194	*+1.5%*
Endowment income & interest	295	178	172	*-3.3%*
Total	**21,007**	**22,215**	**22,729**	***+2.3%***

* Restated data for 2008-09.

27. The sector, as a whole, has made some slightly optimistic assumptions about the levels of HEFCE funding in 2010-11 in its financial forecasts. Total HEFCE recurrent funding is forecast to reduce by 1.2 per cent whereas the latest grant letter from the Secretary of State[4] implies a reduction on 2.6 per cent compared to 2009-10. Table 4 shows the breakdown of public funding assumptions.

Table 4 Percentage change in public funding (cash terms) from financial forecasts submitted in December 2010

	2009-10 Actual	2010-11 Forecast
HEFCE	+2.7%	-1.2%
Department of Health	+6.2%	-2.5%
Research Councils	+2.8%	+3.8%
Training Development Agency for Schools	+4.9%	-3.6%
Skills Funding Agency	+1.3%	-25.4%[†]
Total*	**+2.9%**	**-0.7%**

* Includes deferred capital grants which are excluded from the other rows.

[†] Includes the University of West London's divestment from further education in Reading. Excluding this the sector funding will be -7.4 per cent.

28. The sector's forecasts predict an increase in income from Research Councils of 3.8 per cent in cash terms in 2010-11. Although in broad terms this might seem reasonable, the variation among institutions in changes forecast is between -100 per cent and over +100 per cent.

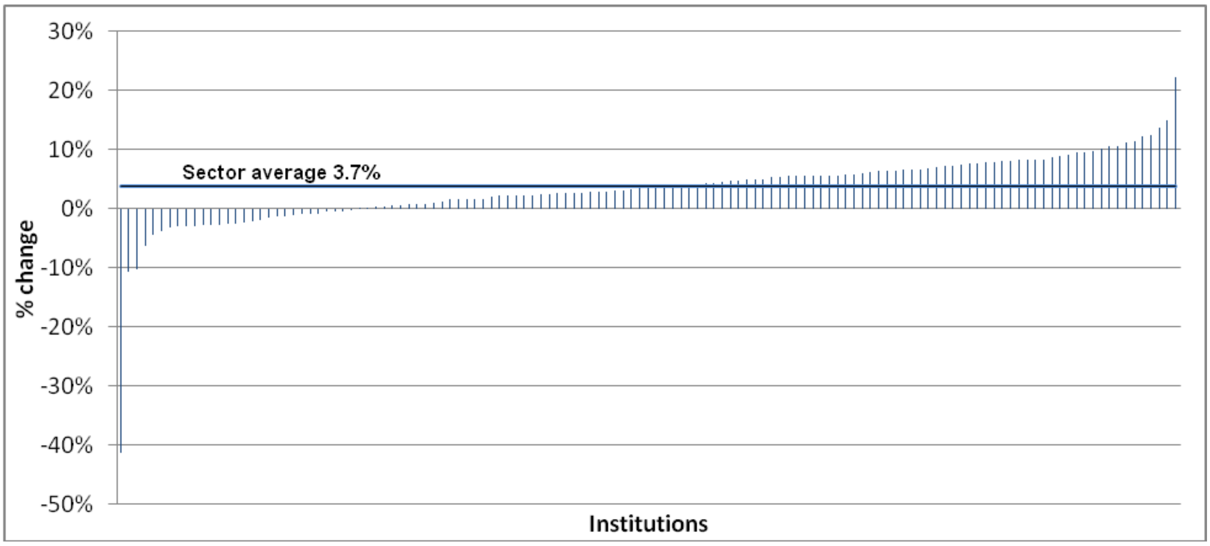
[4] Grant letters can be read in full at www.hefce.ac.uk/finance/fundinghe/grant.

29. As noted the sector is continuing to expect overseas (non-EU) student fee income to increase in 2010-11. Across the sector 21 institutions are forecasting a reduction in overseas fee income, however these are clearly in the minority. At the other end of the scale 21 institutions are expecting fee income to increase by over 25 per cent in 2010-11, with a number of these already being large overseas recruiters. The increased level of competition from both other UK HEIs and organisations in other countries providing courses taught in English implies optimism in current growth forecasts. However the current exchange rates are helping the sector to attract overseas students to the UK.

30. In addition to income growth the sector is forecasting a slight increase in the growth of expenditure. The sector's biggest expenditure continues to be staff costs, which in the year 2009-10 totalled £12,064 million (equivalent to 54.3 per cent of total income). The sector is expecting staff costs to rise by 3.7 per cent in 2010-11, broadly in line with the rise in 2009-10.

31. At individual institutional level the forecast increases in staff costs varies, although most are broadly in line with the sector average. Figure 4 shows the variation across the sector.

Figure 4 Forecast change in total staff costs from 2009-10 to 2010-11



Surpluses

32. The forecasts indicate at an operating level (that is, total income less total expenditure, before any exceptional items) the sector will see a reduction in its surplus in 2010-11 to 1.8 per cent of total income. On a historical cost basis the level of surplus forecast will be 2.4 per cent, which is just below the average over the past 10 years.

Liquidity and borrowings

33. Although the level of liquidity days is currently the highest on record, it is not expected to remain so high. The number of days that liquidity covers expenditure is forecast to fall to 80 days at the end of 2010-11, though this is a still a healthy level. Only three institutions (which is fewer than 2009-10) are expected to have liquidity of less than 10 days.

34. One of the reasons why liquidity is reducing is that the sector is continuing to invest in its infrastructure at significant levels. One indicator of this is the level of capital expenditure in 2009-10 which totalled £2,526 million (a 0.7 per cent increase on the previous year). The sector is

forecasting a further significant increase in capital expenditure during 2010-11 with the total capital expenditure expected to be £3,136 million. Given that most of this expenditure is likely to have been finished during last summer, or to be under way, it is reasonable to expect the actual level to be in line with the forecasts.

35. To help finance these investments in infrastructure the sector continues to increase its borrowings. The sector is forecasting the level of borrowings to rise to £5,093 million at the end of 2010-11 (22.4 per cent of total income), which is £411 million more than at 31 July 2010. Given that the sector already has access to over £1,370 million of financing agreed with lenders but not yet drawn down, the availability of financing should be less of an issue compared to other sectors.

Cash flow

36. The sector continues to forecast cash inflows from operating activities in 2010-11 although this may not be sufficient to finance any expenditure plans not financed by capital grants or borrowings. The large capital expenditure forecast in the next year will require close cash flow management.

Conclusion

37. Overall the financial health of the sector remains sound. However this will come under greater pressure during the next few years as the reductions in public funding following last autumn's spending review are implemented. Higher education institutions are entering a period of transition to a new financial settlement from a position of financial strength, though there will undoubtedly be significant challenges ahead.