FSE0005

Written evidence submitted by Universities UK

About Universities UK

Universities UK is the representative organisation for the UK's universities. Founded in 1918, our mission is to create the conditions for UK universities to be the best in the world, maximising their positive impact locally, nationally and globally. With 140 members and offices in London, Cardiff (Universities Wales) and Edinburgh (Universities Scotland), we promote the strength and success of UK universities nationally and internationally. This response has been developed in consultation with the British Universities Finance Directors Group.

Written submission

Financial pressures facing universities

Funding per student has fallen steadily in real terms over the last six years, and will continue to do so given the government's response to the post-18 review of education and funding, which announced a freeze in the fee cap until 2024-25. The National Audit Office (NAO) has also reported an increase in the proportion of providers reporting deficits, representing increased financial vulnerability across the sector. The DfE estimates that the post-18 review will mean that, over a three-year degree starting in 2022-23, the fee is eroded by £780 per student. UUK estimates that higher education stands to lose £2.2 billion over the period 2022-23 to 2024-25 from this freeze. If the fee cap increased with projected RPIX inflation from 2021-22, it would be £10,226 in 2024-25. Without any inflationary uplift, the fee cap will be £8,367 in 2021-22 prices. In 2020, the OfS estimated that, should a freeze in the fee cap continue, funding per student in 2023-24 will be similar in real terms to the level in 2011-12, which was prior to the increase in fee limit to £9,000.

The freeze in the fee cap up to 2024-25 will add financial pressures to universities on top of six years of declining funding per student. The unit of resource (the value per student of government grant and students' course fee income) has fallen since 2015-16 for home and EU students studying in England. This is due to a lack of inflationary uplift to the fee cap, combined with cuts to government grants from the 2015 Spending Review. Universities have 17% less resource per student now than a decade ago, and this will escalate as inflation climbs higher, particularly with current high inflation rates. The annual inflation rate in the UK was reported at 5.5% in January 2022, its highest level since December 2011. As the unit of resource has been declining, universities are not able to cover their teaching costs with the income received. Deficits are being experienced across all subject areas, with the greatest deficits in medical sciences, computer sciences, and creative arts. A recent report from the NAO, which Universities UK submitted views to, highlighted that there has been a significant increase in the proportion of providers reporting deficits. Even accounting for the impact of pension deficits, this increased from 5% of providers in 2015/16 to 32% in 2019/20. As well as the financial impact from COVID-19, providers must manage systemic risks which precede the pandemic. This includes deficits in publicly funding teaching, costs of research exceeding the value of grants, and the increased cost of pension schemes. These factors have all contributed to the increasing proportion of providers reporting in-year deficits.

The NAO analysis precedes the post-18 review announcements, and it is expected that the additional financial pressure resulting from these announcements will intensify financial pressure and risk for institutions. These financial pressures create reliance on particular income streams, especially international student recruitment, and this reliance will intensify with additional financial stress. The NAO notes that many universities support their research activities and main teaching activities with cross-subsidy from international students. This income stream may be subject to pressure from wider concerns, with overreliance on certain countries that may leave UK universities vulnerable to competition and concerns about current global affairs. UKRI has established a Financial Sustainability of Research Group to consider these issues and build understanding of financial risk in research across the sector. Changes to public support for teaching have had different impacts across the sector. Recent changes in how the OfS allocates public funding has meant that some institutions face reductions in recurrent funding of over 70% for 2021-22 when compared with the previous year. This may pose additional financial risks.

Impact of the pandemic

The global pandemic has created additional, unforeseen financial pressures on universities, and created more competition for domestic and international students. The NAO report discusses losses in international student fees, income from conferences, accommodation lettings and research, as well as increased outlay for COVID-19 security measures. This has intensified systemic financial challenges which precede the pandemic, and placed additional strain on providers across the sector. Some universities have seen increased costs related to COVID-19 compliance and student support (such as hardship funds or accommodation refunds), alongside falls in domestic and international recruitment. The NAO identifies that falls in domestic student recruitment at some providers were related to A-Level grade inflation, where more students secured offers on high-tariff courses. These challenges have not been offset with any savings from a pivot to remote learning and working. A UUK survey of members in July - September 2021 found that 88% of institutions planning for more online provision over the next three years do not expect that it will lead to increases in operational surpluses. Cost savings from remote learning and working are generally offset by IT and capital costs, particularly in the early years of this transition.

Net liquidity, which better reflects funds currently available to universities, has been negatively impacted by the pandemic and continues to decrease across the sector. The 2021 Office for Students (OfS) report on institutions' financial health showed that net operating cashflow, which is necessary to support longer term sustainability, fell from 8.4% of total income in 2019-20 to 4.2% in 2020-21. However, the OfS notes evidence of "sensible and prudent financial management" across the sector throughout the pandemic, including liquidity management. While universities report strong cash reserves following the pandemic, these reserves are widely reported as coming from drawn down borrowing and savings from key expenses. This includes capital projects, staff appointments, and recurrent expenses such as travel costs. The NAO reported that, at the end of the 2020-21 academic year, 64 out of 247 (26%) providers on the OfS register forecast that their balance would fall below 30 days' net liquidity in the next two years. In a UUK survey conducted in 2021, the average institution reported their liquidity being 24% less at the lowest point in the year than the figure reported to the OfS for 2019-20. This difference was worth an average of £16 million per institution. For a quarter of respondents, this difference was as high as £25 million.

Higher education institutions have responded to these challenges with good financial management and efficiency measures. The aggregate view presented by the OfS depicts a stable English HE sector that is expected to recover following the pandemic, and the DfE described universities' "impressive" response to the crisis. Universities have proactively changed the way they work to deliver better outcomes for students, employers, and communities. While major forces, including the pandemic, have accelerated these changes, strategic decision-making has been critical to the sector's achievements. The UK research community also had a central role in responding to the pandemic, with the provision of cutting-edge research and the development of COVID-19 vaccines. The research infrastructure and skills of the research community in our universities allowed the UK to be a global player in responding to the pandemic.

Sector discourse

As a sector representative, UUK has regular and constructive dialogue with the DfE and OfS on financial risks to higher education. The DfE and OfS are aware of challenges facing the sector, and the factors shaping institutions' financial approaches.

How effectively is the DfE protecting students' and taxpayers' interests from risks to higher education providers' financial sustainability?

The funding reform announcements significantly increase the financial pressure facing universities. We have seen evidence of considerable efficiency measures over the last six years of declining funding, but an ongoing reduction cannot be sustained indefinitely without negative impacts on the student experience, the diversity of academic programmes, staff wellbeing, and wider institutional priorities such as net zero targets. All subject areas are experiencing deficits, with some of the greatest deficits in high-priority areas including medical and computer sciences. The government has announced a further £300m for the Strategic Priorities Grant and £450m in capital funding over three years until 2024-25. However, this additional funding announced by government will not be sufficient to offset the impact of a continued fee cap freeze across the board, with estimated losses to be £2.2 billion over the period 2022-23 to 2024-25. If changes in repayment terms for graduates impact on domestic recruitment, this would introduce further financial risk.

The government response to financial risks arising from COVID-19 focused on loan schemes and the restructuring regime, and additional hardship funding for students. This helped providers to weather the most challenging elements of the pandemic, but serious compromises were required elsewhere in order to continue provision. Tuition fee payments totalling around £2.6bn, and quality-related research funding worth £100m, were pulled forward for the first term of the 2020-21 academic year. This helped the sector to stabilise during the most turbulent period, but it did not represent any new funding. An additional £70m was made available for student hardship funds throughout the pandemic. This helped to provide support for students at a time when typical student employment in the hospitality and retail sectors was particularly weakened. However, student demand for support was high, and it was challenging to meet students' needs. A UUK survey on the use of hardship funds found a shortfall in hardship funding across the sector, with some universities having to ration the amount offered for each request in order to ensure all students in need received some support. Universities are also needing to monitor ongoing risks and challenges where there may be increased demand for student compensation.

This focus on the restructuring regime and student hardship has been narrow, and creates future risks. The NAO notes that a key part of the DfE's response to the pandemic was to enhance the role of the cross-government higher education financial sustainability oversight group, in particular by including a representative from HM Treasury. However, it is unclear to what extent the group was able to consider the diversity of the sector in the impact of COVID-19 and different institutions' responses to the crisis. The lack of additional funding has resulted in measures which may pose future risks to the sector. This is particularly true of paused capital expenditure. Many paused capital projects are strategically important to universities, their research and teaching activities, and their local communities. Delays in starting or cancelling these projects may impact universities' competitiveness and their ability to generate benefits to students, businesses, and other users. The falling unit of resource could cause this backlog of investment to grow, which may create longer-term problems. Staff redundancies also create additional pressure on universities' teaching and research activities. Around half of respondents to the 2021 UUK survey on institutions' finances indicated that, if it weren't for COVID-19, a proportion of their reserves would have been spent on staff appointments which needed to be paused. It is essential that universities can maintain the workforce needed to deliver high-quality teaching and research. Institutions will also require sufficient funds to progress towards their net zero goals, in line with sector and government commitments to sustainability. This is an area which can be challenging to prioritise where there are more immediate funding needs elsewhere, and government funding sources are oversubscribed (for example, applications closed for phase 2 of the public sector low carbon skills fund in four days due to the scheme being oversubscribed). The fee freeze to 2024-25 means that funding will continue to fall short of need, with detrimental impacts for student and staff wellbeing, and wider institutional priorities. This reduced resource will require innovative solutions and significant changes to infrastructure to implement the step changes which are required, but resourcing this will be challenging.

Changes in the funding environment may mean some universities wish to undertake significant transformation of their operations. Real transformation of universities' operations requires substantial up-front cost. Some institutions which might see the greatest financial benefit in the long term from transformation may find the short- and medium-term costs prohibitive. There is potential for long-term cost-saving through transformation of the teaching profile, collaborations with other providers and businesses, and improvement of capital assets. It would be valuable for government to incentivise the more ambitious, transformative changes that are needed by institutions through targeted funding or regulatory interventions. Targeted funding could be directed at collaborations which might not otherwise occur due to competitive pressures, or at areas of priority for government (for example: levelling up, lifelong learning, or supporting disadvantaged students). Support for leaders and those involved with governance would be needed to ensure transformative changes are successfully made.

How effectively is the OfS protecting students' and taxpayers' interests from risks to higher education providers' financial sustainability?

The OfS has a role both as a funder and regulator for the higher education sector in England. It evaluates the financial health and sustainability of providers as part of its monitoring, and has the power to intervene where it feels institutions are not being managed prudently. It has powers to distribute funding as appropriate, such as in the case of student hardship grants during COVID-19, and it establishes clear parameters for institutions to receive this funding. In this way, it has a key role in managing financial risk in the higher education sector.

It also requires all registered providers to have a student protection plan in place. These plans set out how providers assess risk and what they will do to protect students from any potential disruption in cases of course, campus or provider closure. This ensures that there are clear processes in place to 'teach out' courses or provide access to suitable and equivalent alternatives. While no student protection plan has ever had to be initiated at short notice, as the

NAO report notes, there have been weaknesses identified in the current model. For example, the success of student protection plans is contingent on a number of factors which are outside of providers' control. Prior to the pandemic, there was an intention from the OfS to consult on changes to this condition of registration.

A recent extension of the regulatory framework has seen the introduction of market exit plans. These come into action in cases where a provider is judged by the OfS to be at material risk of market exit. Here, the OfS will have more oversight and be able to direct certain actions. This was, to some extent, a response to the pandemic where it was assumed there may be some providers at risk and an attempt to overcome the limitations of the current student protection plan regime that would be insufficient in a case of sudden market exit. However, at the time of consultation on market exit plans, UUK raised some concerns about the approach and argued that the OfS needed to pay more attention to improving the effectiveness of existing regulatory approaches and preventing market exit.

For the OfS to act as an effective regulator with regard to financial sustainability and risk, it must consider risks across all income streams. For example, the financial sustainability of research is subject to different risks than teaching. During the pandemic, many universities were forced to pause charity-funded research (where the lowest proportion of full economic cost is met). Similarly, in a survey of 1,099 academics, the COVID-19 crisis was attributed by 64% of respondents to a pivot in universities towards teaching and a reprioritisation of teaching over research. This was exacerbated by cost-saving measures with staff redundancies. The risks to different income streams must be understood, and the OfS should consider how these can be mitigated with effective regulation and funding allocations.

The OfS' publicly available reporting on financial health gives a general, sector-wide view. While this reporting acknowledges that the impacts of financial risks will differ across the sector, it is important that the challenges facing diverse institutions are fully understood. For policy-making by the DfE to be most effective, it must be informed by evidence that reflects the full range of challenges. The institutions which the OfS regulates are extremely diverse, and financial risk is managed very differently by these institutions, both in the degree and effect of specific risks. This was noted in the NAO report, which observed that providers of many different types are experiencing financial stress. Some generalisation is possible, such as institutions with a greater proportion of international students being more affected in cases where international recruitment is threatened. However, the NAO found that institutional profile cannot predict financial strength. It noted that size of institution, entry requirements, and specialist status were not predictors of financial strength or risk. For example, the 20 providers reporting in-year deficits for three years or more vary in size from 200 students to over 30,000. Further, not all institutions have been affected equally by the ongoing challenges of the pandemic. The long business cycle of higher education is still being affected by COVID-19, with open days, the admissions cycle, and ongoing teaching still shaped by the pandemic. Institutions are feeling the impact to differing degrees and in different areas of their offering. For this reason, financial risk management must acknowledge the diversity of institutions, and understand the differing impacts of regulatory practices across the sector. This was also recommended in the NAO report, recognising the complexity of the sector. It is equally important that there are opportunities for the DfE to understand the diversity of the sector, and how policy decisions impact differentially across providers, so that institutions' financial sustainability can be protected where possible.

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