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**Issues paper**

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This report is for information

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This report provides an overview of the financial health of the HEFCE-funded higher education sector in England. The analysis covers financial results for the academic year 2012-13 and forecasts for 2013-14, as submitted to HEFCE in December 2013.

# Financial health of the higher education sector

## **2012-13 financial results and 2013-14 forecasts**

# Financial health of the higher education sector

## 2012-13 financial results and 2013-14 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 of the financial health of the HEFCE-funded higher education sector in England. The analysis covers financial results for the academic year 2012-13 and forecasts for 2013-14, as submitted to HEFCE in December 2013.
2. The report is being published to provide universities and higher education colleges with feedback on their financial performance in 2012-13 and their estimates for 2013-14, before they submit their updated financial forecasts in July 2014 (as requested in 'Annual accountability returns 2013', HEFCE 2013/23). The analysis also provides other stakeholders with information about the current financial health of the sector.

#### Context

3. It is important to note that the analysis provided in this report on the projected financial performance for 2013-14 is based on financial forecasts which were submitted by institutions before the Government's grant letter to HEFCE in February 2014. These forecasts do not reflect the impact of the significant reductions in funding for teaching announced in this letter.
4. In addition, the impact of the relaxation of student number controls, announced in the Government's autumn 2013 statement, does not come into effect until 2014-15 and so is beyond the financial forecasting period analysed in this report.
5. These announcements, along with a new requirement on institutions to include pension scheme liabilities (for multi-employer pension schemes) on their balance sheets, will have a significant impact on the financial plans and performance of institutions in future, and will need to be reflected in the next set of financial forecasts for the period (2013-14 to 2016-17), due to be submitted to HEFCE in July 2014.

#### Key points

6. The financial results for the sector in 2012-13 are sound overall, and stronger than projected by the sector in July 2013. The improvement in the financial outturn when compared

with projected performance may be due to prudent forecasting, which is a pattern we have seen in previous years.

7. Overall the sector reported operating surpluses of £956 million (3.9 per cent of income), which were £17 million less than the level reported for 2011-12 (4.2 per cent of income). Strong cash balances and healthy reserve levels were also reported in 2012-13, but it should be noted that there continue to be significant variations in the financial performances of individual institutions across the sector.

8. In 2013-14, the latest forecasts show that the sector is projecting a further rise in total income, driven mainly by projected increases in tuition fees from home and overseas, although a rise in staff costs and other operating expenses will cause projected surpluses to fall to 2.2 per cent of total income.

9. The next set of financial forecasts, for the period 2013-14 to 2016-17, is due to be submitted by higher education institutions in July 2014. These forecasts will need to include assumptions about the impact of the relaxation of the student number controls from 2014-15, as well as of the recent funding settlement announcement, which incorporates significant reductions in teaching funding for the forecast period.

10. The increase in the student number control in 2014-15 and the removal of the cap in 2015-16, announced in the Government's autumn 2013 statement, will create new opportunities and risks for institutions and are likely to stimulate greater competition within the sector. Additionally, institutions will face increasing levels of uncertainty over student recruitment, with some institutions being more successful in attracting students than others. This could lead to greater volatility of financial forecasting and a widening of institutional financial performance in the coming years.

11. The student number projections accompanying the financial forecasts for 2013-14 show that the sector expects the number of full-time home and European Union (EU) undergraduate students (across all years of study) to be similar to the number reported for 2012-13. However, the decline in part-time home and EU student numbers is set to continue, with the sector projecting part-time undergraduate student numbers to fall by 10.2 per cent in 2013-14.

12. In terms of overseas student recruitment, the latest data for 2012-13 and 2013-14 indicate a slowing of growth in the numbers of overseas students recruited by the sector, compared to recent years, which could make plans for income growth more difficult to achieve. This could have a material impact on the sector as overseas fee income represents a significant source of income for many institutions.

13. The latest financial forecasts for 2013-14 show that the sector plans to significantly increase expenditure on capital infrastructure, from £2,646 million in 2012-13 to £3,861 million (a rise of 46 per cent). To help fund this level of expenditure, the sector requires £2,249 million from its own cash reserves (equivalent to 8.9 per cent of total income) and plans to borrow an additional £560 million, which will cause total sector borrowing to rise to £6,833 million by 31 July 2014 (equivalent to 27 per cent of total income). While borrowing is forecast to rise in 2013-14, forecasts show that net liquidity is expected to fall by £1,173 million to £6,224 million by 31 July 2014, below the projected sector borrowing level. The additional capital expenditure in 2013-14 is partially supported by government funding for capital projects and future forecasts will have been influenced by the government spending review announcement of increased capital grants in June

2013. However, growth in capital investment from 2015-16 may not be sustainable without continued government support. This support is important to sustaining the quality of infrastructure in the higher education sector as it provides both funding and confidence to others to continue investing in the sector.

14. Although short-term health is not a concern, some institutions will need to increase surpluses above current levels, to address previous under-investment or to invest further in capital infrastructure, where they wish to deliver greater capacity in light of the changes to the student number control system.

15. Discretionary reserves, after taking into account projections for pension deficits, increased by £2.6 billion in 2012-13, to reach £11.5 billion as at 31 July 2013, and are projected to reach £12.3 billion by the end of 2013-14. However, 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.

16. While sector reserves are currently strong overall, future reserve levels and pension deficits are likely to be significantly affected by the introduction of a new financial reporting standard (FRS102), which requires institutions to recognise liabilities relating to deficit recovery plans for multi-employer pension schemes such as the Universities Superannuation Scheme (USS) in their balance sheets from 2015-16. While not a new liability, it will increase the transparency of the underlying deficits within the pension schemes, which based on the latest interim valuation of the USS scheme, are likely to be significant.

17. The USS Members' Annual Report published on 10 October 2013 confirms that the USS scheme deficit stood at £7.9 billion as at the end of June 2013, with the next full financial assessment due in March 2014. This indicates that sector reserves could be significantly overstated, depending on the value of the USS deficit, and that a deficit recovery plan is likely to be required to ensure the continued viability of the scheme. Confidence levels in the financial strength of the sector may be impacted by the inclusion of USS deficits on institutions' balance sheets.

18. We are aware that the impact of these changes, as well as of the recent government announcements relating to student number controls and grant funding reductions, will not be consistent across the sector and that, despite the sector as a whole being currently in a sound financial position, a number of institutions may find themselves more vulnerable than others as a result of these changes.

19. We will publish an update on the financial health of the sector in the autumn, when we have analysed all higher education institutions' financial forecasts for the next reporting period 2013-14 to 2016-17.

### **Action required**

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

## Overview

21. Higher education institutions (HEIs) in England are required to send us their annual accountability returns at two points during the year. These returns form a significant part of the way in which HEIs can demonstrate accountability for the public funds distributed to them.

22. We primarily use the information collected to:

- confirm the use of HEFCE funds for the purposes intended, including compliance with the Financial Memorandum<sup>1</sup>
- form a basis for discussions with institutions about their progress in key areas, their priorities for strategic development, and their current and future performance (including financial sustainability)
- largely determine our risk assessments for each institution
- identify trends across the sector and advise the Secretary of State for Business, Innovation and Skills on its needs and development
- monitor HEIs' reporting of information relating to their charitable status, in accordance with our role as a principal regulator under the terms of the Charities Act 2006.

23. The annual accountability returns are also a key element of HEFCE's institutional assurance and risk framework. They complement our cycle of assurance reviews and data audits to provide a coherent regulatory approach to HEIs. The various accountability returns that HEIs submit to HEFCE provide assurance to all investors and to the community that each institution serves.

24. This report provides an overview of the financial health of the sector as assessed in the first stage of our review process. It will provide universities and higher education colleges with feedback on their financial performance in the academic year 2012-13 and original estimates for 2013-14, before they submit their updated financial forecasts in July 2014. The analysis also provides stakeholders with information about the current financial health of the sector.

25. The data used in this report come from two main sources. All data up to and including 2011-12 are from the Higher Education Statistics Agency's Finance Statistics Record. They reflect the actual figures as submitted in the financial statements for that year, or as subsequently amended on request by HEFCE. Information covering the period 2012-13 to 2013-14 is from HEIs' financial returns submitted to us in December 2013. Some comparisons are also made with the financial results and forecast data submitted in July 2013. All financial information is presented in academic years (ending 31 July). For references to real-terms changes in performance we have used HM Treasury's gross domestic product deflator, announced in December 2013<sup>2</sup>.

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<sup>1</sup> Further information on the Financial Memorandum between HEFCE and institutions is available at: [www.hefce.ac.uk/whatwedo/reg/instfinance/financialmemorandum](http://www.hefce.ac.uk/whatwedo/reg/instfinance/financialmemorandum)

<sup>2</sup> We have used the latest Gross Domestic Product deflators published by HM Treasury. The figures used were released on 8 January 2014, and can be found at: [www.hm-treasury.gov.uk/data\\_gdp\\_index.htm](http://www.hm-treasury.gov.uk/data_gdp_index.htm)

## Assessing financial sustainability for 2013-14 and beyond

26. In preparing their financial forecasts, institutions identified a number of risks to the forecasts' accuracy and their financial performance:

- fall in student recruitment and retention in an increasingly competitive market
- further unanticipated public spending cuts
- failure to effectively manage major capital investment programmes and their financial impacts
- rise in the cost of borrowing
- failure to achieve overseas student recruitment targets
- rise in staff and pension costs
- non-compliance with visa regulations
- failure to achieve staff recruitment and retention targets.

27. The accuracy of financial forecasts depends on what assumptions have been made by HEIs and to what extent they have taken the risks above into account.

28. It is important to note that these latest financial forecasts were submitted before the Government's February 2014 grant letter to HEFCE and so do not reflect the impact of the changes to funding levels announced in this letter.

29. Future forecasts will also need to include assumptions about the impact of the increase in the student number control in 2014-15 and the removal of the cap in 2015-16, as announced in the Government's autumn 2013 statement.

30. As demand for higher education exceeds the supply of available places, the changes to the student number control will create new risks and opportunities for institutions, as well as stimulating greater competition within the HE sector. Institutions are likely to face increasing levels of uncertainty over student recruitment, with some institutions being more successful in attracting students than others. This could lead to greater volatility of financial forecasting and a widening of institutional financial performance in the coming years.

31. It is important to note that HEIs continue to undertake their own scenario planning and sensitivity analysis to assist them in developing their financial forecasts. We encourage institutions to continue to assess the potential impacts of future changes on their operations, and where necessary to identify mitigating actions. This scenario planning will need to consider potential changes in student demand as a result of the changes to the student number control, potential capacity constraints, the availability of public funding, and pay and pensions pressures.

32. We will continue to support the sector through our regular engagement with HEIs as it enters this new period of uncertainty, and will continue to discuss the actions being taken by institutions to mitigate potential adverse impacts.

## Summary and headline information

33. Table 1 provides a summary of the key financial results for 2012-13 and shows the projected performance in 2013-14 (as indicated in the December 2013 forecasts).

**Table 1 Summary of key financial indicators**

|   | Actual   |          | Forecast |
|---|----------|----------|----------|
|   | 2011-12  | 2012-13  | 2013-14  |
| Total income  | £23,277M | £24,319M | £25,337M |
| Operating surplus   | £972M    | £956M    | £547     |
| Operating surplus as % of total income                      | 4.2%     | 3.9%     | 2.2%     |
| Historical cost surplus                                     | £1,138M  | £1,212M  | £720M    |
| Historical cost surplus as % of total income                | 4.9%     | 5.0%     | 2.8%     |
| Cash flow from operating activities as % of total income    | 8.1%     | 8.3%     | 6.6%     |
| Net liquidity as number of days' expenditure                | 118      | 123      | 98       |
| External borrowings as % of total income                    | 23.5%    | 25.8%    | 27.0%    |
| Discretionary reserves excluding FRS17 as % of total income | 56.0%    | 61.7%    | 62.9%    |

*Note: FRS17 is the financial reporting standard on retirement benefits.*

## Financial performance

34. The financial results for the higher education sector in 2012-13 remain strong when compared with 2011-12, and are better than those projected by the sector in July 2013. Overall, the sector reported sound surplus levels, large cash balances and healthy reserve levels. As in previous years, the results show that the sector-wide picture encompasses a wide range of financial results across institutions. The main financial strength of the sector remains in a small number of institutions.

35. The projected out-turn for 2013-14 is not as strong as the preceding three years but is sound overall. However, as discussed earlier in this report, these forecasts exclude the impact of the grant funding reductions announced in the Government's grant letter to HEFCE in February 2014, which will require institutions to reassess their projections.

36. The key messages from the analysis of the 2012-13 annual accounts are included in the following section.

## Income

37. Total income increased by £1,042 million (4.5 per cent) to £24,319 million during 2012-13, with the fall in funding council grants (£1,186 million) more than offset by the rise of £1,538 million in income from tuition fees (excluding from international students). Table 2 provides a breakdown of sector income for the last two years and the percentage change in income streams.

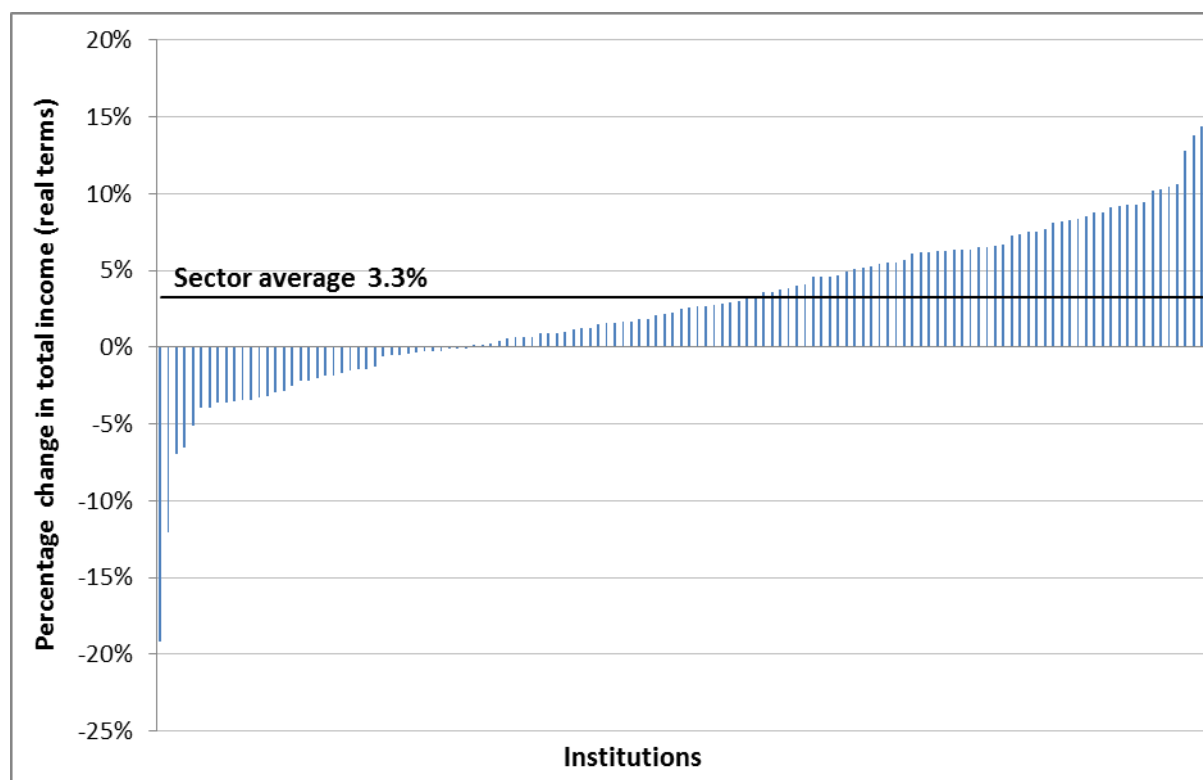
**Table 2 Breakdown of total income**

|  | <b>2011-12</b>  | <b>2012-13</b>  | <b>% change</b> |
|--|-----------------|-----------------|-----------------|
| Funding council grants   | £6,690M         | £5,504M         | -17.7%          |
| Overseas fee income  | £2,762M         | £2,978M         | 7.8%            |
| Tuition fees and education contracts (Home and European Union) | £5,614M         | £7,152M         | 27.4%           |
| Research grants and contracts                                  | £3,650M         | £3,875M         | 6.1%            |
| Other operating income   | £4,325M         | £4,574M         | 5.8%            |
| Endowment income and interest                                  | £236M           | £237M           | 0.3%            |
| <b>Total income</b>  | <b>£23,277M</b> | <b>£24,319M</b> | <b>4.5%</b>     |

38. While income increased overall, just under a third of the HEIs in the sector (38) recorded real-terms reductions in income in 2012-13, compared with 88 HEIs in 2011-12. The reasons for these income reductions were varied but, in most cases, were due to lower levels of grant funding (not covered by increases in tuition fee income), or reductions in overseas tuition fee income or other operating income. Figure 1 shows the real-terms changes to total income recorded by HEIs between 2011-12 and 2012-13. This demonstrates the wide variation in performance across the sector.



**Figure 1 Real-terms percentage changes in total income (2011-12 to 2012-13)**



39. In cash terms, total tuition fee income (including fees from international students) increased by £1,754 million in 2012-13, equivalent to a 20.9 per cent increase upon 2011-12 levels. Table 3 provides a breakdown of tuition fee income received in 2012-13 compared with 2011-12.

**Table 3 Breakdown of tuition fee income**

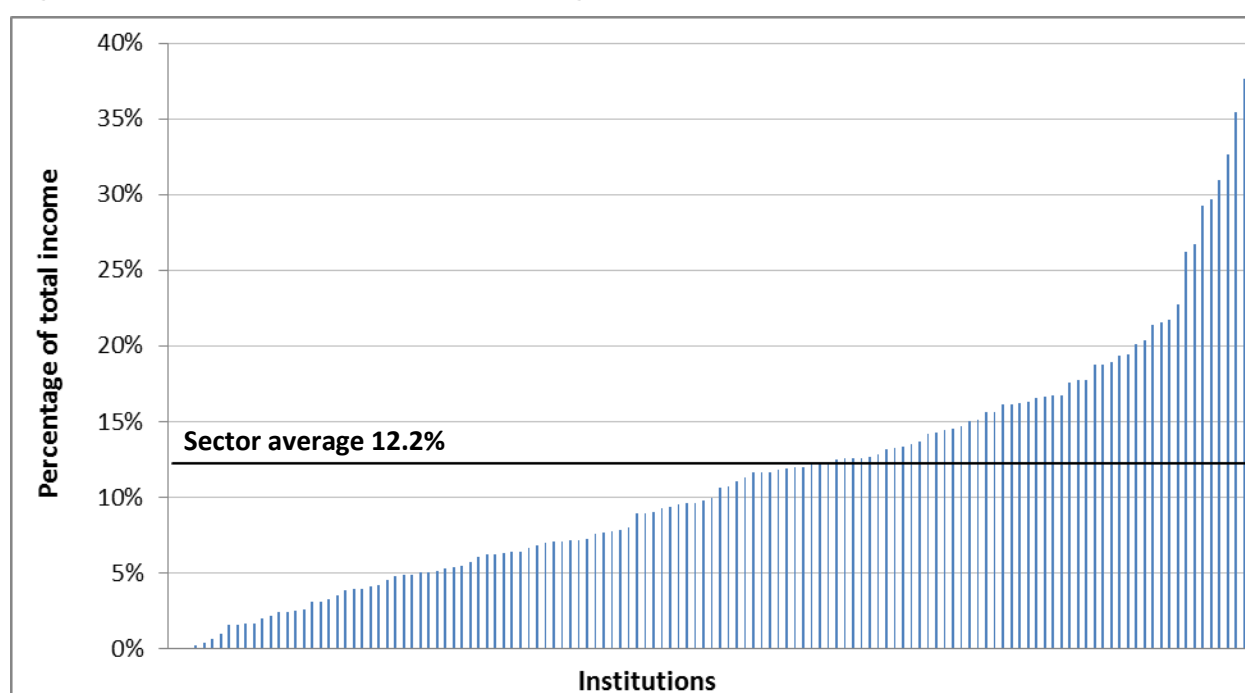
|                         | <b>2011-12</b> | <b>2012-13</b>  | <b>% increase</b> |
|-------------------------|----------------|-----------------|-------------------|
| FT UG (home and EU)     | £3,093M        | £4,477M         | 44.7%             |
| FT PG (home and EU)     | £570M          | £668M           | 17.2%             |
| PT (home and EU)        | £550M          | £621M           | 13.0%             |
| Health (home and EU)    | £760M          | £734M           | -3.4%             |
| Overseas                | £2,762M        | £2,978M         | 7.8%              |
| Other                   | £642           | £653M           | 1.6%              |
| <b>Total fee income</b> | <b>£8,376M</b> | <b>£10,130M</b> | <b>20.9%</b>      |

*Note: FT – full-time; PT – part-time; UG – undergraduate; PG – postgraduate; EU – European Union.*

40. Table 3 shows that the sector is reporting continued growth in fee income from overseas students, which has more than doubled in real terms since 2000-01. In 2012-13, overseas fee income rose by £215 million, equivalent to a rise of 7.8 per cent compared with 2011-12. Despite this level of growth, overseas student numbers (across all years of study) grew by only 1.2 per cent in 2012-13 (compared to 4.8 per cent in 2010-11 and 4.6 per cent in 2011-12).

41. Dependence on overseas fee income varies between institutions, ranging from 0 per cent to 37.6 per cent of total income, although the number of institutions reporting a greater reliance on this source of income is growing. In 2012-13, 14 institutions reported overseas fee income of over 20 per cent of total income, compared with 10 institutions in 2011-12 and four institutions in 2008-09. In 2012-13, the 20 institutions recording the highest income from overseas fees account for just over 50 per cent of the sector's total income from this source. Figure 2 shows the distribution in 2012-13.

**Figure 2 Overseas fee income as percentage of total income (2012-13)**

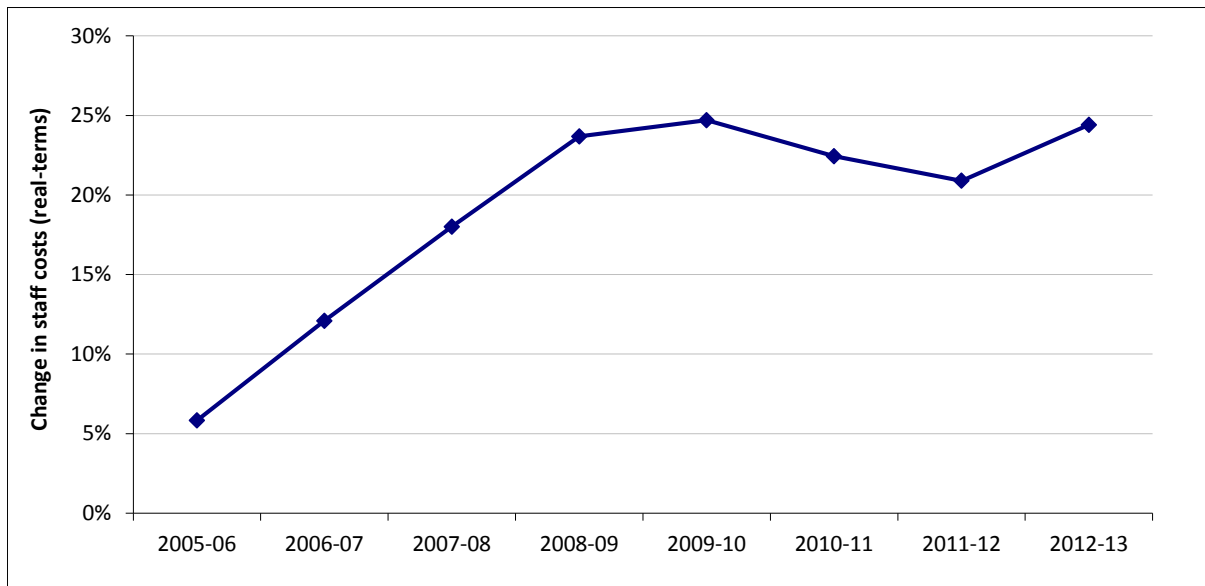


## Expenditure

42. In 2012-13 total expenditure increased by 4.7 per cent in cash terms, compared with the increase of 5.1 per cent forecast for the same period in July 2013. The sector's biggest expenditure relates to staff costs, which totalled £12,753 million in 2012-13, equivalent to 52.4 per cent of total income.

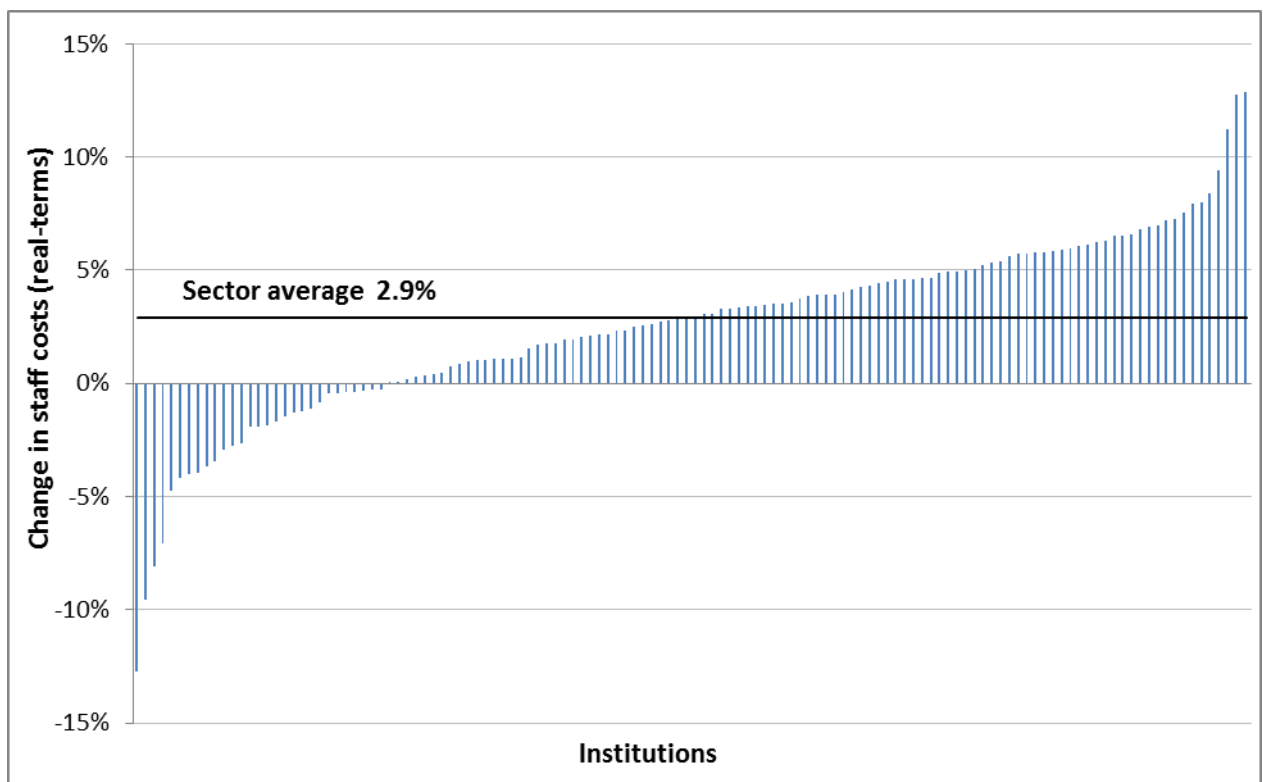
43. In real terms, staff costs increased by 2.9 per cent in 2012-13. This compares with a real-terms fall in staff costs reported by the sector in both 2010-11 and 2011-12, but follows a period of significant growth in prior years. Figure 3 shows the cumulative change in real-terms staff costs since 2005-06.

**Figure 3 Cumulative real-terms change in staff costs (2005-06 to 2012-13)**



44. While the sector reported a small increase in staff costs overall in 2012-13, this masked considerable variation between institutions. Figure 4 shows the distribution of changes in staff costs across the sector from 2011-12 to 2012-13.

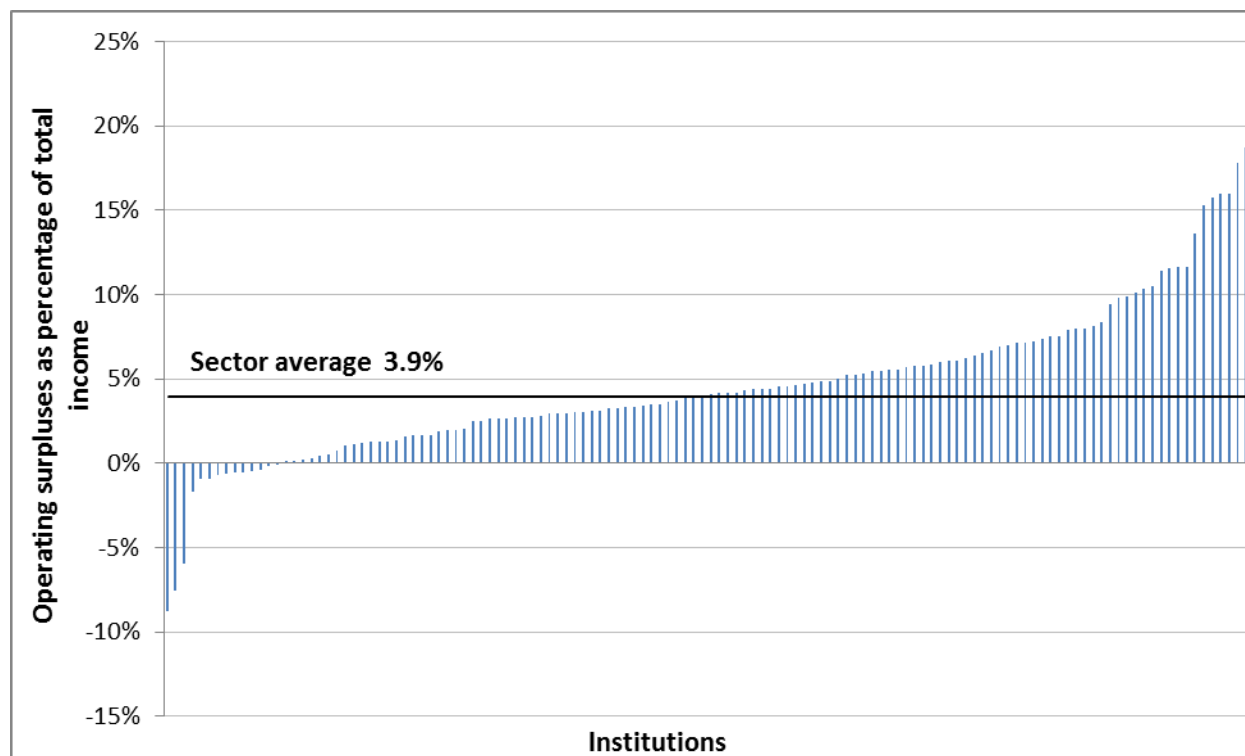
**Figure 4 Real-terms percentage changes in staff costs (2011-12 to 2012-13)**



## Surpluses

45. The sector's operating surplus (that is, its total income less its total expenditure before any exceptional items) fell from £972 million in 2011-12 to £956 million (equivalent to 3.9 per cent of total income) in 2012-13. Within the sector, 14 institutions reported operating deficits in 2012-13, compared with 12 in 2011-12. Figure 5 shows the level of operating surpluses as a percentage of total income reported by institutions in 2012-13.

**Figure 5 Operating surpluses as a percentage of total income (2012-13)**



46. While the majority of institutions have produced better financial outturns in 2012-13 compared with the July 2013 forecasts, 31 institutions reported a decline in their operating performance compared with their earlier predictions.

47. On a historical cost basis the sector recorded a surplus of £1,212 million (5.0 per cent of total income), which again is significantly better than the average over the past 10 years (which was 3.5 per cent)<sup>3</sup>. The large difference between the operating and historical position in 2012-13 is partly accounted for by exceptional items (for example profit or loss from the sale of properties, or exceptional restructuring) totalling £98 million. Figure 6 shows the level of operating and historical cost surpluses as percentage of total income since 2001-02.

<sup>3</sup> Historical cost surplus (or deficit) is derived by adjusting 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 or deficit provides greater consistency for comparing results between institutions.

**Figure 6 Operating and historical cost surpluses as percentage of total income 2002-03 to 2012-13**



### Liquidity and cash flow

48. At the end of 2012-13 the sector had net liquidity of £7,397 million, equivalent to 123 days' expenditure, the highest level on record<sup>4</sup>. This is higher than the level forecast in July 2013 and the level reported at the end of 2011-12, which were both 118 days. Five institutions had liquidity of less than 20 days, compared with four institutions in 2011-12.

49. This improvement in liquidity, largely as a result of increased borrowings, precedes the major capital expenditure planned for 2013-14.

50. Cash flow from operating activities totalled £2,026 million in 2012-13, which compares favourably with the forecasts provided in July 2013 (£1,538 million). The level of cash flow in 2012-13 was equivalent to 8.3 per cent of total income, an increase from the level reported for 2011-12, which was 8.1 per cent. This is in line with the general sector trend, which shows that the sector has been increasing its cash flow gradually each year since 2004-05. This is a positive indicator of solvency, and is particularly important given the current uncertainty in the higher education sector.

### Capital expenditure and borrowing

51. Capital expenditure totalled £2,646 million in 2012-13, which was £295 million higher than the level reported in 2011-12.

<sup>4</sup> Net liquidity is equal to current asset investments, plus bank and cash balances, less bank overdrafts. The indicator can also be expressed as the number of days' operating expenditure covered by the net liquidity.

52. Borrowing in the sector rose significantly, from £5,472 million at the end of July 2012 to £6,273 million at the end of July 2013 (equivalent to 25.8 per cent of income). The sector also had another £572 million of financing agreed with lenders but not drawn down at the end of October 2013. Borrowing of £288 million was drawn down between 1 August and 31 October 2013.

53. Interest payments and other finance costs rose by 2.4 per cent in 2012-13, increasing from £348 million in 2011-12 to £357 million in 2012-13. The sector's annualised servicing costs rose to 2.47 per cent of income in 2012-13 (compared with 2.44 per cent in 2011-12).

### **Reserves**

54. Discretionary reserves at the end of 2012-13 totalled £11,511 million, after taking into account the impact of the financial reporting standard on retirement benefits (FRS17)<sup>5</sup>. This reporting standard, which requires pension scheme surpluses or deficits to be included in the balance sheet (but not yet those of multi-employer schemes such as the Universities Superannuation Scheme (USS)), makes comparisons with previous years more difficult. Without FRS17, reserves totalled £15,013 million, equivalent to 61.7 per cent of total income.

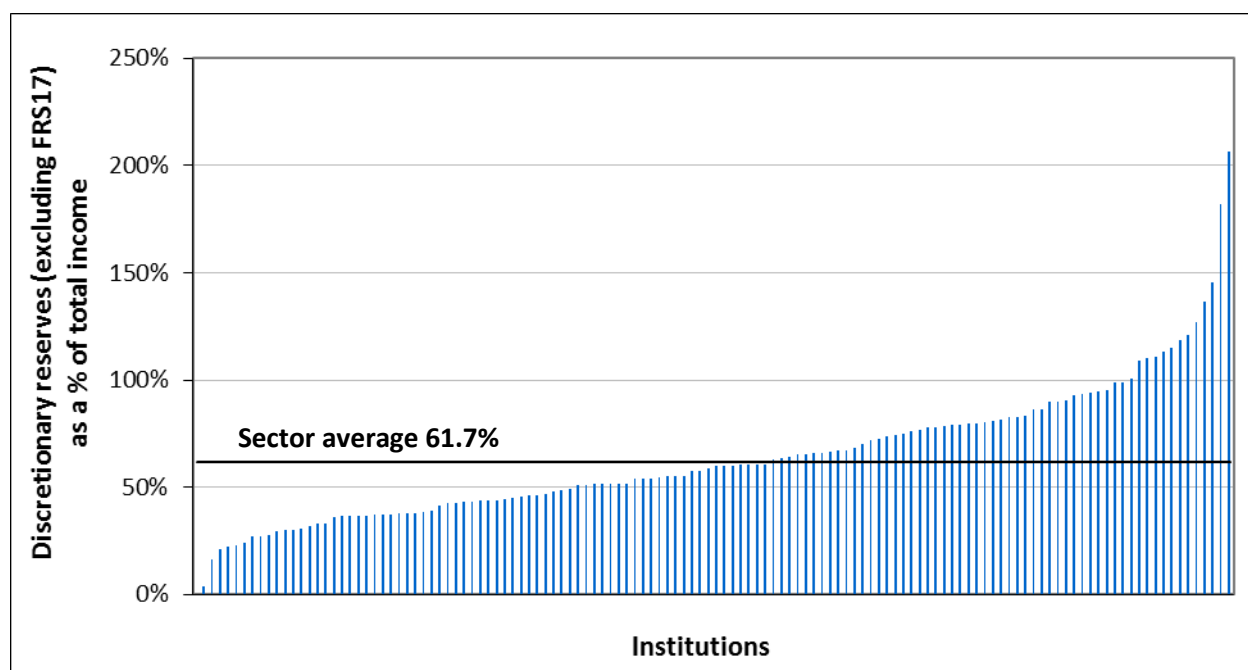
55. Total pension scheme deficits fell by £564 million to £3,502 million in 2012-13, which reduced reserves to 47.3 per cent of income. In the main, the funding position of sector pensions improved in 2012-13, due to an improvement in the market conditions underlying the financial assumptions on which, under FRS17, pension scheme liabilities are calculated. However, pension deficits and reserve levels could look different in future years due to the new financial reporting standard FRS102, which will require institutions to recognise liabilities relating to deficit recovery plans for multi-employer pension schemes (such as USS) in their balance sheets. More information relating to the potential impact of these changes is included later in this paper.

56. 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 7 shows the spread of reserves (excluding FRS17) as a percentage of total income, reported as at 31 July 2013.

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<sup>5</sup> Discretionary reserves are equal to expendable endowments plus general reserves from the balance sheet.

**Figure 7 Discretionary reserves as percentage of total income (2012-13)**



### **Financial forecast for 2013-14**

57. The projected out-turn for 2013-14 is not as strong as the preceding three years but is sound overall. However, these forecasts exclude the impact of the government grant funding announcements made in February 2014, which will require institutions to revisit their financial forecasts for this period and beyond.

58. The key messages from the analysis of the latest projections for 2013-14 are included in the following section.

### **Income**

59. Current forecasts show that the sector is projecting that total income will increase by 4.2 per cent over the year, to reach £25,337 million in 2013-14. This is marginally higher than the income projected in July 2013 which was £25,240 million. Table 4 provides a breakdown of the forecast income levels and compares these with actual income received in 2012-13.

**Table 4 Breakdown of income levels (cash terms)**

|   | <b>2012-13<br/>Actual</b> | <b>2013-14<br/>Forecast</b> | <b>% change</b> |
|---|---------------------------|-----------------------------|-----------------|
| Funding council grants  | £5,504M                   | £4,506M                     | -18.1%          |
| Overseas fee income   | £2,978M                   | £3,267M                     | +9.7%           |
| Tuition fees and education contracts<br>(Home and European Union) | £7,152M                   | £8,677M                     | +21.3%          |
| Research grants and contracts                                     | £3,875M                   | £4,127M                     | +6.5%           |
| Other operating income  | £4,574M                   | £4,543M                     | -0.7%           |
| Endowment income and interest                                     | £237M                     | £217M                       | -8.3%           |
| <b>Total income</b>   | <b>£24,319M</b>           | <b>£25,337M</b>             | <b>+4.2%</b>    |

60. Following changes to the Government's approach to funding teaching in higher education, from 2012-13, HEFCE teaching grants were reduced for students starting studies from September 2012. At the same time, tuition fees for students increased to compensate for the reduction in grant funding.

61. Overall, the sector is expecting funding council grants to fall by 18.1 per cent in 2013-14<sup>6</sup>. This reduction will be offset by a rise in tuition fees and education contracts for home and European Union (EU) students of 21.3 per cent. In real terms, combined income from these two categories is expected to rise by 3.4 per cent.

62. The forecasts show that the sector is projecting overseas (non-EU) fee income to rise by 9.7 per cent to reach £3,267 million in 2013-14, lower than the level of fee income projected for the same period in July 2013. This indicates that some institutions are expecting slower growth in the overseas student market, making plans for income growth more difficult to achieve. This could have a material impact on the sector as overseas fee income represents a significant source of income for many institutions.

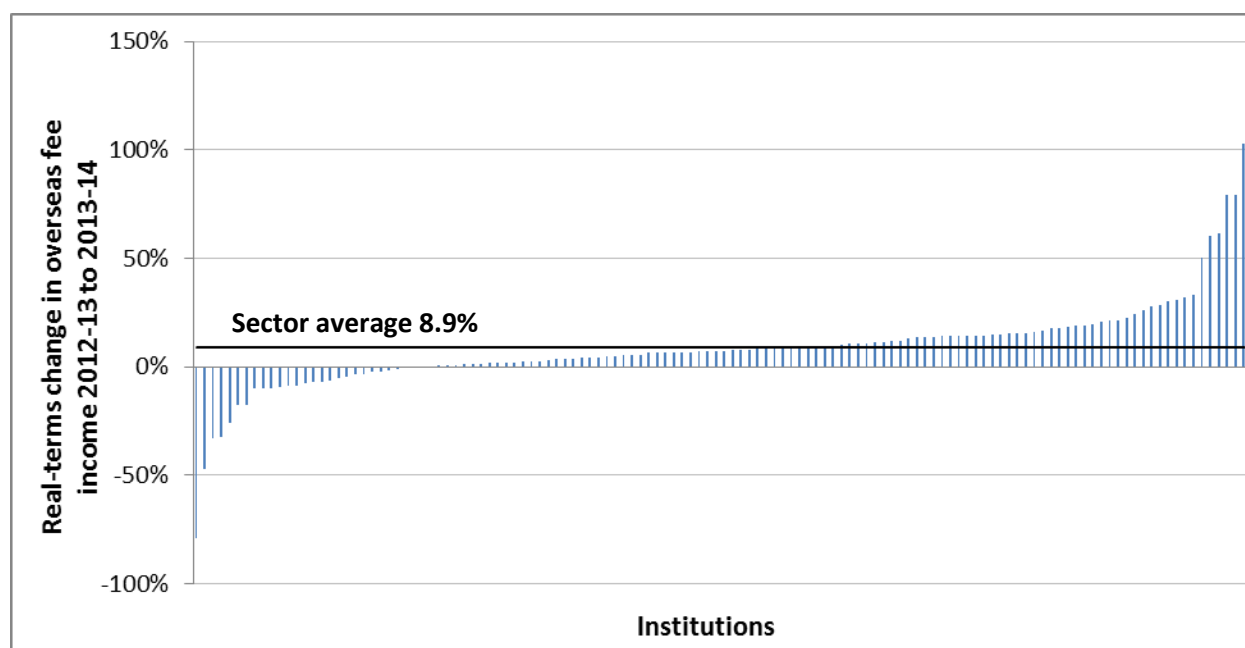
63. As in previous years, there remains a large degree of variation in the assumptions used by institutions in their overseas forecasts, with 19 institutions expecting overseas fee income to rise by over 20 per cent in 2013-14 and 26 institutions expecting it to fall. The variation in assumptions is demonstrated in Figure 8; this shows the change in overseas fee income (in real terms) projected by institutions in 2013-14.

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<sup>6</sup> This will include HEFCE, the Skills Funding Agency and the National College for Teaching and Leadership.



**Figure 8 Real-terms change in overseas income (2013-14 compared with 2012-13)**



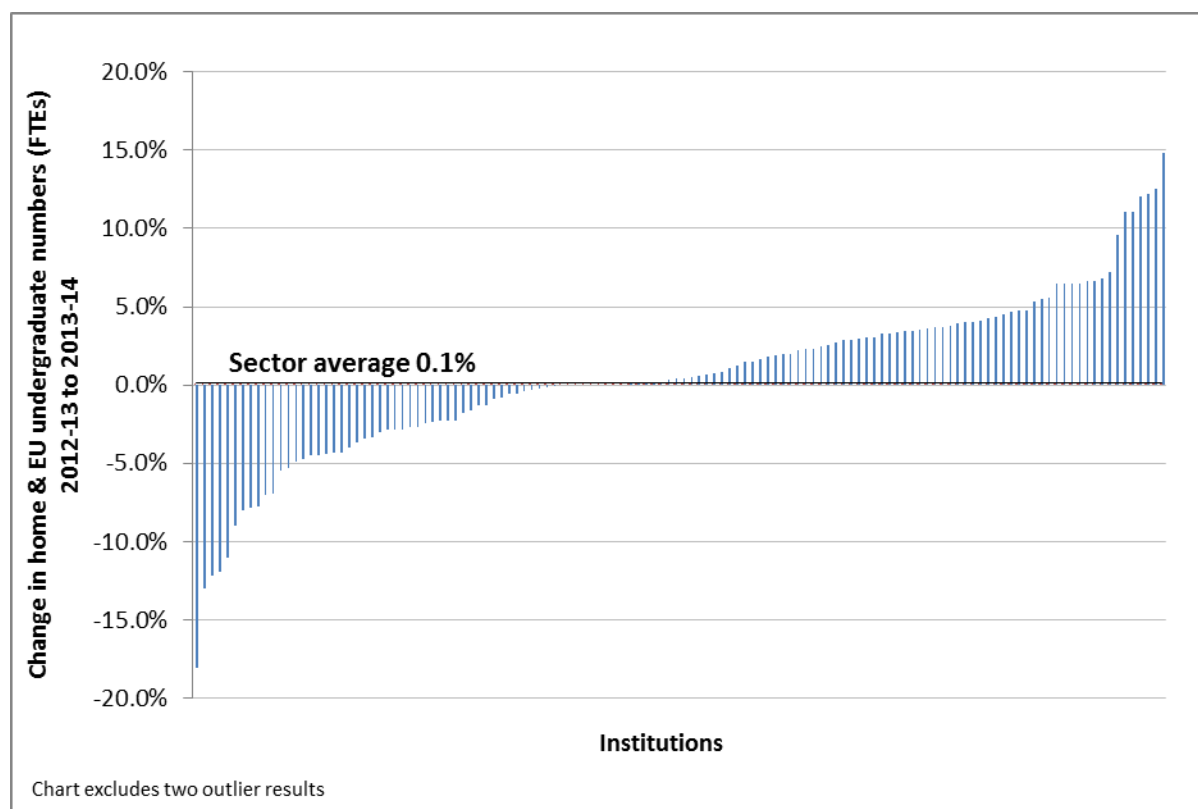
#### **Student numbers for 2013-14**

64. Given that a large proportion of the sector's income depends on the number of students recruited, we ask institutions to support their financial projections with student number forecasts, expressed as full-time equivalents.

65. These forecasts predict that, at an aggregate level for all years of study, home and EU undergraduate student numbers will fall by an average of 1.2 per cent in 2013-14, although when broken down into full- and part-time study, forecasts show that the sector expects full-time undergraduate numbers to rise marginally (by 0.1 per cent), whereas part-time undergraduate numbers are projected to decline by 10.2 per cent compared with 2012-13.

66. Figure 9 shows the forecast changes in full-time home and EU undergraduate student numbers between 2012-13 and 2013-14 for all institutions and across all years of study. These show the variation in assumptions used by institutions when developing their financial forecasts.

**Figure 9 Forecast changes in home and EU full-time undergraduate student numbers (between 2012-13 and 2013-14)**



67. Forecasts show a similar pattern for home and EU postgraduate students in 2013-14, with rising student numbers in the full-time student group alongside a fall in the part-time student group for both postgraduate taught and postgraduate research students. Table 5 provides a breakdown of the student number returns submitted by institutions in December 2013. This includes actual student numbers reported for 2011-12 and 2012-13 alongside the student number forecasts for 2013-14.

**Table 5 Breakdown of Home and EU postgraduate student numbers**

|  | 2011-12<br>Actual | 2012-13<br>Actual | 2012-13<br>change | 2013-14<br>Forecast | 2013-14<br>projected<br>change |
|--|-------------------|-------------------|-------------------|---------------------|--------------------------------|
| <b>Full-time Postgraduate taught</b>   | 86,330            | 81,123            | <b>-6.0%</b>      | 87,867              | <b>8.3%</b>                    |
| <b>Part-time Postgraduate taught</b>   | 55,579            | 53,444            | <b>-3.8%</b>      | 50,832              | <b>-4.9%</b>                   |
| <b>Full-time Postgraduate research</b> | 39,932            | 39,739            | <b>-0.5%</b>      | 41,594              | <b>4.7%</b>                    |
| <b>Part-time Postgraduate research</b> | 11,485            | 11,455            | <b>-0.3%</b>      | 11,293              | <b>-1.4%</b>                   |

*Note: figures reflect all years of study and are expressed as full-time equivalents.*

## **Expenditure**

68. In 2013-14, the sector is projecting total expenditure of £24,688 million, a rise of 6.3 per cent compared with 2012-13. In real terms, this is equivalent to a rise of 5.5 per cent.

69. The real-terms rise in staff costs is projected to be 6.1 per cent in 2013-14. Some of this increase is due to a projected rise in staff numbers, which are expected to increase at similar levels to 2012-13. This follows a fall in staff numbers in 2010-11 and 2011-12.

70. As in previous years, at individual institutional level the predicted changes in staff costs vary, ranging from a reduction of 8.2 per cent to an increase in real terms of 16.6 per cent.

## **Surpluses**

71. The forecasts indicate that at an operating level the sector will see a reduction in its surplus from 3.9 per cent in 2012-13 to 2.2 per cent of total income in 2013-14, marginally higher than the surplus forecast for the same period in July 2013, which was 2.0 per cent.

72. On a historical cost basis the level of surplus forecast is 2.8 per cent of total income, which is below the average over the past 10 years (3.7 per cent) but above the level forecast in July 2013 (2.6 per cent).

## **Liquidity and cash flow**

73. Projections show that the sector is expecting net liquidity to fall from £7,397 million as at 31 July 2013 to £6,224 million by the end of 2013-14. This is equivalent to 98 days' expenditure, which compares with 123 days as at the end of 2013. Seven institutions expect to have liquidity of less than 20 days in 2013-14 (compared with five institutions in 2012-13).

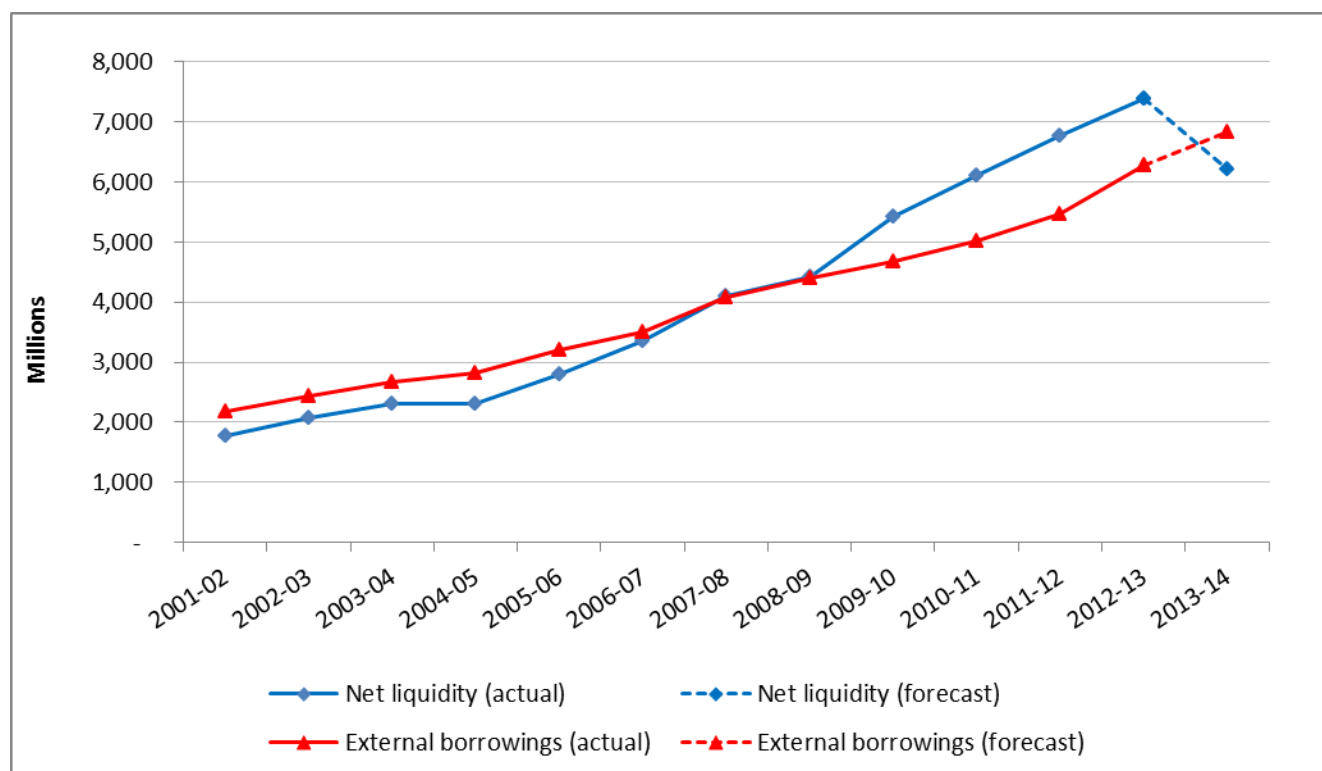
74. If the financial out-turn for 2013-14 is as projected, the level of net liquidity held by the sector at the end of 2013-14 will fall below sector borrowing, which is expected to reach £6,833 million by 31 July 2014. Figure 10 shows the actual and forecast levels of net liquidity and borrowing for the period 2001-02 to 2013-14. The sharp drop in liquidity projected by the sector in 2013-14 is partly due to significant planned investment in infrastructure in this year.

75. Strong liquidity is necessary for HEIs efficiently to manage the potential increased volatility and unpredictability arising from the changes in the funding system, as well as the increasing competition within the higher education sector at home and abroad.

76. The sector is forecasting cash inflows of £1,663 million from operating activities in 2013-14, a fall of £363 million from the level reported in 2012-13 but higher than the cash inflows projected in July 2013, which were £1,535 million.

77. While the number of institutions forecasting negative cash flows in 2013-14 is expected to fall (from 11 institutions in 2012-13 to eight institutions in 2013-14), these latest forecasts show that cash in-flows from operating activities will be insufficient to fund the capital expenditure plans not already financed by capital grants or borrowings. The large capital expenditure forecast in 2013-14 will therefore require close cash flow management.

**Figure 10 Net liquidity and borrowing (2001-02 to 2013-14)**



### Capital expenditure and borrowing

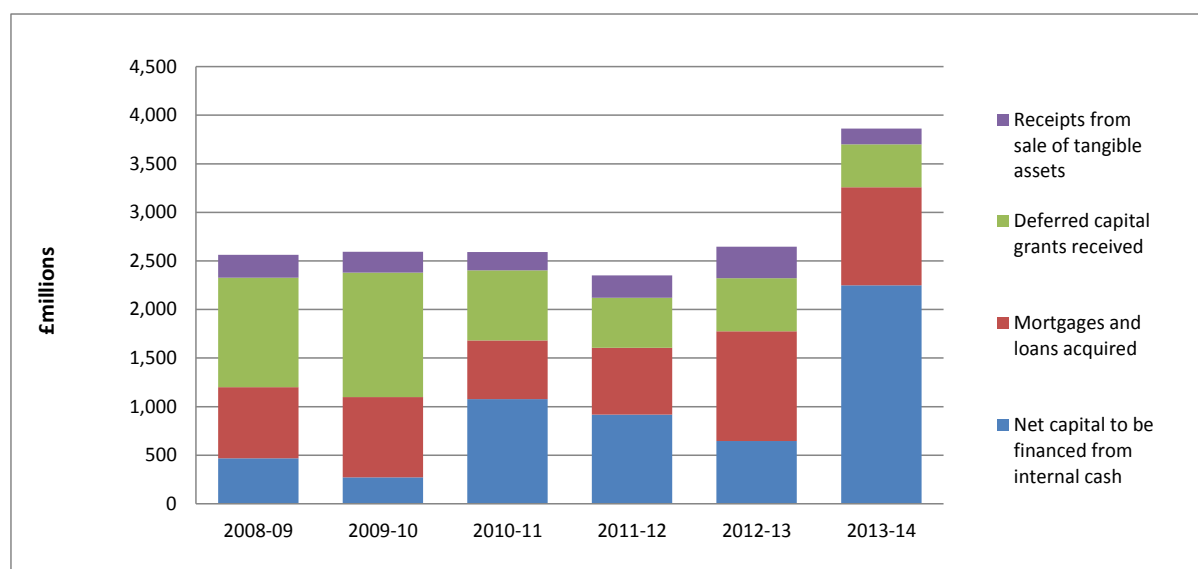
78. Capital expenditure is projected to rise significantly, from £2,646 million in 2012-13 to £3,861 million in 2013-14, representing an increase of 46.0 per cent.

79. Figure 11 provides a breakdown of how capital expenditure was funded in the period from 2008-09 to 2012-13, with an indication of how the sector is expecting to fund its investment in infrastructure in 2013-14. This shows a diminishing level of capital grants alongside a significant increase in borrowing and the level of net capital financed (or to be financed) by internal cash.

80. In 2013-14, the sector is expecting to receive £441 million in deferred capital grants and projects, so that it will need £2,249 million of internal cash to finance its net capital requirements. This equates to 9 per cent of the sector's total income projections for 2013-14.

81. Despite the rise in capital investment, some institutions will need to increase surpluses above current levels in future years, to address previous under-investment or to deliver greater capacity, should they wish to recruit more students following the lifting of the student number cap in 2015-16.

**Figure 11 Funding breakdown of capital expenditure (2008-09 to 2013-14)**



82. The decline in capital grants over recent years has resulted in more institutions seeking to fund major capital projects by extending their borrowing. By 31 July 2014, the sector is projecting that borrowings will rise by £560 million to reach £6,833 million (equivalent to 27.0 per cent of total income). The sector also has access to over £572 million of financing agreed with lenders but not yet drawn down, which suggests that the availability of financing should be less of an issue compared with other sectors. However, changes in the banking market have meant that lenders are reducing the period of loans and requiring more restrictive covenants, as well as introducing higher rates of interest. The increase in interest and capital payments to service these borrowings will cause a rise in 'fixed costs' which could put pressure on some institutions that fail to constrain other costs or to increase income.

### Reserves

83. Discretionary reserves are forecast to increase to £12,283 million at the end of 2013-14, after taking into account projections of the impact of FRS17, which forecast that total pension scheme deficits will rise over the year by £3,644 million. However, uncertainty over pension deficits, which depend on actuarial assumptions, could significantly affect this figure.

84. There continues to be a risk that the sector's reserves could come under further pressure if pension liabilities increase, significantly impacting its financial health. Also, the new financial reporting standard, FRS102 (requiring institutions to recognise liabilities relating to deficit recovery plans for multi-employer pension schemes such as USS in its balance sheets) is likely to put further pressure on reserves from 2015-16.

85. The USS Members' Annual Report published on 10 October 2013 confirms that the USS scheme deficit stood at £7.9 billion as at the end of June 2013, with the next full financial assessment due in March 2014. Although reserves are strong overall, there is a risk that the sector reserves could be significantly overstated depending on the value of the USS deficit.