FINANCIAL SUSTAINABILITY OF COLLEGES AND UNIVERSITIES IN SCOTLAND
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## FINANCIAL SUSTAINABILITY OF COLLEGES AND UNIVERSITIES IN SCOTLAND

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The Scottish Funding Council (SFC) has a key role in ensuring that the institutions we fund continue to plan and manage their activities in a way which ensures their sustainability and financial viability. This contributes to the success of students and researchers, local communities and the wider Scottish economy. Financial sustainability is, therefore, a condition of grant and is set out in our Financial Memorandum.

This report presents an aggregate picture of the financial health of Scottish institutions based on a review of their latest forecasts. The analysis includes twenty incorporated and six non-incorporated colleges and eighteen higher education institutions. While this report presents an aggregate position, there is significant variation in the financial position of individual institutions.

1 Colleges provided Financial Forecast Returns (FFRs) covering the period 2020-21 to 2023-24 in October 2021; Higher education institutions provided Strategic Plan Forecast (SPF) returns for the years 2020-21 to 2022-23 at the end of June 2021.
2 The Open University in Scotland is not included in this analysis due to different reporting arrangements in place. While the Open University has operations in Scotland, the institution’s accounts are only produced on a UK basis.
Financial management is a dynamic process and the information contained within this report is an update to the information provided in our report published on 29 June 2021 as part of phase three of the SFC Review of Coherent Provision and Sustainability: Financial sustainability of colleges and universities June 2021. At the time of writing, we have received some, but not all, institutions’ 2020-21 annual reports and accounts. We plan to report on actual results achieved for 2020-21 in June 2022.

FINANCIAL SUSTAINABILITY OF THE COLLEGE SECTOR

The financial sustainability of the college sector is very fluid, with assumptions being updated as circumstances change. All the figures in this section capture incorporated and non-incorporated colleges.

KEY MESSAGES

• As a result of additional funding from SFC, and their own mitigating actions, colleges managed the impact of the COVID-19 pandemic more positively than anticipated but longer-term financial sustainability remains challenging, with the sector forecasting deficits over the next two years;
• As a result of an additional one-off injection of £15 million SFC grant to address the challenges of the global pandemic, Coronavirus Job Retention Scheme (CJRS) income of £9.5 million and lower staff and other operating costs, the sector forecast adjusted operating position for 2020-21 has improved with a projected surplus of £16.7 million. Two colleges are expecting to report adjusted operating deficits in 2020-21;
• However, the financial outlook is challenging with the sector forecast adjusted operating position expected to deteriorate to a deficit of £5.7 million in 2021-22, followed by a deficit of £2.7 million in 2022-23, before returning to a small surplus of £2.0 million in 2023-24. Twelve colleges are forecasting adjusted operating deficits in both 2021-22 and 2022-23, reducing to nine colleges in 2023-24;
• The additional funding made available to the college sector through COVID-19 support has helped to stabilise institutions’ finances through the pandemic but it is important to note that this is non-recurring funding. While the 2021-22 budget includes additional COVID-related ‘consequentials’ in the form of one-off funds, it excludes the SFC financial sustainability funding and CJRS income provided in 2020-21;
• Colleges remain heavily dependent on SFC grant funding which is forecast to amount to 79% of total income at a sector level in both 2020-21 and 2021-22;
• Most forecasts assume that student activity and other income targets will be achieved during 2021-22, however, these targets are likely to prove challenging to achieve in the context of the continued impact of the COVID-19 pandemic and may potentially result in recovery of SFC grant.
• One-off cost savings generated during 2020-21 will not be repeated and staff and other operating expenses are expected to increase across the forecast period reflecting a return to pre-COVID levels of activity with a return to full campus operations. Colleges have also highlighted inflationary cost pressures which are particularly impacting on capital projects while the rising cost of living is also increasing pressures in relation to pay settlements and running costs;
• Cash balances of £121.7 million and £64.9 million are forecast at the end of July 2021 and July 2022 respectively. The July 2021 position is much improved on previous forecasts due to a combination of the more favourable operating position as a result of the additional SFC grant and unspent balances of ‘ring-fenced’ SFC monies. It is expected that unspent 2020-21 funds will be spent or recovered during 2021-22;
• Three colleges are forecasting a negative cash position throughout the period 2021-22 to 2023-24. The projected combined cash deficit for the three colleges at 31 July 2024 amounts to £2.6 million; and
• The aggregated sector position masks varying degrees of challenges across all individual colleges.
ACTIONS TO DATE


ENHANCED FLEXIBILITY

• We did not recover SFC funds for COVID-19 related shortfalls against core activity targets during 2020-21;
• We increased flexibility in the administration of student support funds;
• We undertook an in-year redistribution exercise of student support to meet requests for additional funding in 2020-21 (£1.6 million) and we repurposed and reallocated £5 million unspent funds to allow colleges to provide students with equipment and support those in hardship;
• We extended timescales for spending the Flexible Workforce Development Fund (FWDF) and increased the 2020-21 budget; and
• We provided flexibility in grant drawdowns to several colleges encountering liquidity challenges.

REDUCING REPORTING BURDENS

• We kept returns and reporting requirements to a minimum; and
• Updated the college credit guidance.

PROVIDING ADDITIONAL FUNDS

• Additional funding was made available, from 2020-21, through the introduction of the Young Person’s Guarantee programme and the National Transitional Training Fund;
• The Coronavirus Job Retention Scheme (CJRS) provided additional income during 2019-20 and 2020-21;
• We provided additional funding for student mental health and wellbeing support during 2020-21;
• Additional funding was made available for college student associations and unions during 2020-21;
• We provided an additional £15 million of financial sustainability funding during 2020-21, distributed to all colleges, to help address the major impact that COVID-19 has had on colleges in terms of reduced commercial income, increased COVID-related costs and general weakening of their financial sustainability;
• We allocated funding to three colleges for income lost during 2020-21 in providing student accommodation rent rebates;
• We provided an additional £3 million winter COVID-19 discretionary funds for colleges during 2020-21;
• We provided £6.5 million additional capital funding for support economic recovery during 2020-21; and
• We provided £2.3 million additional capital funding to support digital provision during 2020-21.

ADJUSTED OPERATING POSITION

The Financial Forecast Return includes an adjusted operating position section. The methodology for calculating the adjusted operating position, or underlying position, has been agreed following sector consultation with a view to ensuring consistency of approach and interpretation of colleges’ financial performance.

Depreciation and pension adjustments (non-cash items that are beyond a college’s immediate control) account for most of the difference between the operating position and the adjusted operating position. Incorporates colleges receive a ‘non-cash’ budget to cover depreciation but this additional budget is not recognised under the FE/HE Statement of Recommended Practice (SORP) accounting rules.

The overall adjusted operating position for the sector, is set out in both the table and graph below:

<table>
<thead>
<tr>
<th>Year</th>
<th>Adjusted operating surplus/(deficit)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2018-19</td>
<td>Actual £‘000</td>
</tr>
<tr>
<td>2019-20</td>
<td>Forecast £‘000</td>
</tr>
<tr>
<td>2020-21</td>
<td>Forecast £‘000</td>
</tr>
<tr>
<td>2021-22</td>
<td>Forecast £‘000</td>
</tr>
<tr>
<td>2022-23</td>
<td>Forecast £‘000</td>
</tr>
<tr>
<td>2023-24</td>
<td>Forecast £‘000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Year</th>
<th>Adjusted operating surplus/(deficit)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2018-19</td>
<td>12,887</td>
</tr>
<tr>
<td>2019-20</td>
<td>4,065*</td>
</tr>
<tr>
<td>2020-21</td>
<td>16,728</td>
</tr>
<tr>
<td>2021-22</td>
<td>(5,668)</td>
</tr>
<tr>
<td>2022-23</td>
<td>(2,664)</td>
</tr>
<tr>
<td>2023-24</td>
<td>2,027</td>
</tr>
</tbody>
</table>

* Figures restated from those previously reported to reflect updated figures for Orkney College (2019-20 accounts).

Annually Managed Expenditure (AME) pension adjustments may also impact on the reported operating position. Consequently, we would expect to see operating deficits reported across the college sector.

The adjusted operating position is therefore intended to reflect the financial performance after allowing for non-cash adjustments and other material one-off or distorting items required by the SORP. The adjusted operating position is designed to smooth any volatility in reported results arising from the implementation of Financial Reporting Standard 102 and to recognise that some of the reported costs do not have an immediate cash impact on the college. This should give a better indication of the college’s operational cash generating capacity and a clearer picture of a college’s short-term financial health.

The overall adjusted operating position for the sector is set out in both the table and graph below:

FINANCIAL SUSTAINABILITY OF COLLEGES AND UNIVERSITIES IN SCOTLAND
As a result of an additional one-off injection of £15 million SFC grant to address the challenges of the global pandemic, Coronavirus Job Retention Scheme (CJRS) income of £9.5 million and lower staff and other operating costs, the sector forecast adjusted operating position for 2020-21 has improved with a projected surplus of £16.7 million. Two colleges are expecting to report adjusted operating deficits in 2020-21. At the time of writing, we have received some but not all colleges’ 2020-21 annual accounts. We will issue an update on the actual results achieved in 2020-21 once all the accounts have been signed and submitted.

Based on the latest forecast information, the sector adjusted operating position is expected to deteriorate to a deficit of £5.7 million in 2021-22. While the 2021-22 budget includes additional COVID-related ‘consequentials’ in the form of one-off funds, it excludes the SFC financial sustainability funding and CJRS income provided in 2020-21. Colleges’ costs are also expected to increase to pre-COVID levels in 2021-22. For some colleges, expenditure that was due to be incurred in 2020-21 has also been delayed to 2021-22. However, uncertainties around recruitment, income generation, and pay awards may affect the final position for 2021-22.

Most colleges are forecasting that student activity and other income targets will be achieved during 2021-22, however, these targets are likely to prove challenging in the context of the continued impact of the COVID-19 pandemic. While some colleges have stated that they expect to make up the shortfall, others have factored under-delivery against 2021-22 activity targets into their forecasts. Colleges are facing increased competition from universities for students as a result of widening access policies that have enabled young people from disadvantaged communities to go direct to university and improved SQA results, while recruitment levels have also been impacted by young people staying at school for longer and/or going directly into employment because of the buoyant jobs market.

A sector adjusted operating deficit of £2.7 million is forecast in 2022-23 with a return to a small surplus of £2.0 million projected for 2023-24. It should be noted that it is anticipated that the 2022-23 funding allocation will be less favourable in comparison to the planning guidance provided to colleges for the forecast and therefore the forecasts for 2022-23 (and 2023-24) may represent a more optimistic position. Final 2022-23 funding allocations are expected to be announced in May 2022.

Twelve colleges are forecasting adjusted operating deficits in both 2021-22 and 2022-23 before reducing to nine colleges in 2023-24.

The impact of the COVID-19 global pandemic on colleges’ income is evident in the recent forecasts provided by colleges. COVID-19 accounts for reductions in other operating income against 2019-20 levels albeit the most recent 2020-21 position is improved against previous 2020-21 projections as a result of additional COVID funding. There are limited opportunities for colleges to increase surplus-generating commercial income, and developing income streams has become more challenging as a result of increases in staff costs following the implementation of National Bargaining harmonisation and job evaluation in recent years. However, CJRS income of £9.5 million and other cost savings have helped to mitigate the reduction in that revenue stream. Tuition fee and education contract income is forecast to gradually increase against 2019-20 levels over the planning period.

Colleges remain heavily dependent on SFC grant funding which is forecast to amount to 79% of total income at a sector level in both 2020-21 and 2021-22. The 2021 FFR forecasts reflect the additional SFC 2020-21 financial sustainability funding of £15 million, announced in March 2021, which was allocated to colleges in proportion to their respective main teaching grant allocations and which recognised that all colleges were facing financial pressures. Conditions of the funding included supporting students in finishing their courses and achieving their qualifications, minimising deferrals, and enabling necessary organisational change to be implemented fairly and reasonably. In addition, a further c£300,000 was allocated to three colleges for income lost during 2020-21 in providing student accommodation rent rebates.
EXPENDITURE

The graph below indicates the projected movement in sector expenditure over the forecast period:

Staff costs continue to represent the largest element of expenditure for colleges and are expected to constitute 69% of total sector costs in 2020-21, reduce to 67% in 2021-22 and remain at 68% for the last two years of the forecast. Colleges expect to report staff restructuring costs of £6.2 million in 2020-21 (13 colleges), a large proportion of which is funded from the additional financial sustainability funding, reducing to £2.7 million in 2021-22 (five colleges). Colleges have highlighted challenges in terms of the affordability of meeting the future costs of pay awards and being able to self-fund staff restructuring programmes in future years. Many colleges also operated a freeze on non-essential recruitment during the COVID lockdown but this represented a one-off saving and staff costs are expected to increase as vacancies are filled and activity returns to pre-COVID levels.

Other operating costs are expected to reduce in 2020-21 against the previous year. Colleges have indicated that savings have been generated during the year in the following areas: academic materials and consumables; residences and catering; utilities; property costs; photocopying; and travel and subsistence. However, colleges have also reported that they have incurred additional costs related to online learning and remote working. On the other hand, student support, which is demanded, has not been a cost pressure in 2020-21 on the basis of returns provided.

The estimated annual cost of the 1.25% increase to employer National Insurance contributions across the sector (to be implemented from April 2022) is estimated to exceed £5 million. Colleges have also highlighted inflationary cost pressures in their latest financial forecast returns. In particular, these are impacting on the delivery costs associated with capital projects while the rising cost of living is also increasing pressures in relation to pay settlements and running costs.

Cash balances of £121.7 million and £64.9 million are forecast at the end of July 2021 and July 2022 respectively. The July 2021 position is much increased on 2019-20 (£73.3 million) and previous 2020-21 projections due to a combination of the more favourable operating position as a result of the additional SFC grant and unspent balances of ‘ring-fenced’ SFC monies, some of which relate to additional funding provided during the pandemic. This includes colleges placing on hold capital works because of restrictions enforced through the COVID-19 lockdown and unspent student support funds. It is expected that unspent 2020-21 funds will be spent or recovered during 2021-22.

Only one college is forecasting fewer than 20 days’ cash reserves at the end of July 2021, increasing to ten colleges by the end of July 2022 as cash balances drop. This is reflected in the sector position which shows the number of cash days reducing from 60 to 30 over the same period.

Three colleges are forecasting a negative cash position throughout the period 2021-22 to 2023-24. The projected combined cash deficit for the three colleges at 31 July 2024 amounts to £2.6 million. SFC continues to engage closely with these colleges in managing liquidity and operational challenges.
CASH INFLOW FROM OPERATING ACTIVITIES

This measure provides an indication of the financial health of an institution in terms of its day-to-day operations, as it does not include any items of non-cash expenditure (such as depreciation, amortisation and, most importantly, adjustments for pension liabilities), or income from and expenditure on financing activities.

<table>
<thead>
<tr>
<th>College sector operating cash flow indicators</th>
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<tbody>
<tr>
<td>Actual 2019-20</td>
</tr>
<tr>
<td>-----------------</td>
</tr>
<tr>
<td>60,000</td>
</tr>
<tr>
<td>40,000</td>
</tr>
<tr>
<td>20,000</td>
</tr>
<tr>
<td>0</td>
</tr>
<tr>
<td>-20,000</td>
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<tr>
<td>0</td>
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</tbody>
</table>

Based on the latest returns, two colleges are forecasting negative net cash inflow from operating activities in 2020-21, increasing to 18 in 2021-22 reflecting the weaker projected operating position in that year. Across all colleges, the sector net cash inflow from operating activities as a proportion of total income has moved from 5.8% in 2019-20 to 10.4% in the FFR for 2020-21, reducing to -2.1% for 2021-22 and then returning to a positive position in the last two years of the forecast.

BORROWING

Total borrowing, including colleges’ Non-Profit Distributing (NPD) and Private Finance Initiative (PFI) commitments, is expected to decrease from £254.5 million at the end of July 2020 to £210.1 million by the end of July 2024. Excluding NPD/PFI commitments, total borrowing is forecast to decrease from £29.1 million to £20.0 million over the same period.

<table>
<thead>
<tr>
<th>College sector borrowing indicators</th>
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<tbody>
<tr>
<td>Actual 2019-20</td>
</tr>
<tr>
<td>-----------------</td>
</tr>
<tr>
<td>200,000</td>
</tr>
<tr>
<td>150,000</td>
</tr>
<tr>
<td>100,000</td>
</tr>
<tr>
<td>50,000</td>
</tr>
<tr>
<td>0</td>
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</tbody>
</table>

Fifteen colleges are projecting outstanding borrowing at the end of July 2024. No college reported any breach of bank covenants during 2020-21. Overall capital expenditure of £505.9 million is projected in the period up to the end of July 2024.
MITIGATING ACTIONS

Colleges reacted rapidly to the COVID-19 crisis and undertook a variety of measures to mitigate the impact on their operations. Measures included vacancy management and mission critical only recruitment, freezing non-essential spend and delaying capital spend.

Staff costs represent the largest element of college expenditure. Given that the sector has in previous years delivered significant non-staff cost efficiencies, this is the area that colleges are focused on to make efficiencies in the event of income targets becoming challenged. Colleges have highlighted that operational impacts of staff reductions are serious in terms of both reputation and impact on student outcomes (quality, retention and other performance indicators) and in relation to the mental health, morale and turnover of remaining staff.

In terms of achieving 2021-22 activity targets, colleges have provided assurances that this risk is also being addressed through undertaking scenario and contingency planning, proactive budget monitoring, effective curriculum planning and management, developing stronger partnerships with schools, universities, employers and industry, increased marketing activity, implementation of business process improvement initiatives, estates rationalisation, shift in delivery patterns and through ensuring that electronic devices are available for students.

While the additional 2020-21 and 2021-22 funding made available to the college sector through COVID-19 support has helped to stabilise institutions’ finances, it is important to note that this is non-recurring funding.

Colleges’ latest forecasts for the years 2020-21 to 2023-24, along with additional financial returns over the coming months, will continue to further develop our understanding of COVID-19 impacts on individual colleges and the overall sector, and enable provision of further advice to Scottish Government.

PHOTO: ARGYLL COLLEGE UHI

KEY RISKS

The most significant risk areas for colleges that could adversely affect their financial performance and sustainability relate to:

• Increasing staff costs arising from cost of living pay awards, increases in employer contributions to pension schemes and national insurance, and the outcome of the National Bargaining job evaluation exercise for support staff;
• Inflationary pressures will put significant added pressure on the ability of colleges to continue to deliver similar levels of activity without an increase in funding;
• The continued impact of the COVID-19 pandemic including the potential consequential failure to achieve student activity and other income targets;
• Maintaining short-term liquidity;
• Changes to the SFC funding model and colleges’ ability to deliver regional outcome agreements and Government priorities;
• The impact of cost efficiencies, including reduced staff numbers and frontline student services, on both the quality of student experience, student outcomes, and on the health and wellbeing of college staff;
• Future arrangements for funding Foundation Apprenticeships;
• The requirement for colleges to self-fund the cost of staff restructuring programmes while not being able to hold reserves;
• The uncertainty of the UK Government’s policies designed to mitigate the effects of leaving the EU, in particular the development of the Shared Prosperity Fund;
• Addressing the increasing level of backlog estates maintenance and ICT/digital requirements to deliver a 21st century learning and teaching environment;
• Challenges of diversifying income due to increased competition from external providers reducing colleges’ ability to generate commercial surpluses; and
• Delivering against multiple funding streams and programme requirements.

PHOTO: MORAY COLLEGE
At this current time, the financial sustainability of the university sector remains extremely fluid, with assumptions being constantly updated as circumstances change.

**KEY MESSAGES**

- As a result of additional funding from SFC, and their own mitigating actions, institutions managed the impact of the COVID-19 pandemic more positively than anticipated but longer-term financial sustainability remains a challenge for many institutions;
- The latest projections show that the university sector is forecasting an underlying** surplus of £226.1 million for 2020-21 compared to the previous forecast (April 2021) of an underlying surplus of £154.8 million. This is largely accounted for by additional income of £52.2 million, due to higher international fee income, SFC grant, research grant, CJRS income, residence income and other income generating activities, and lower staff and other operating costs of £19.1 million;

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3 The reported operating surplus/(deficit) for the year does not represent the underlying operating performance of institutions as it will also include non-operational items required to be accounted for under the Financial Reporting Standard 102 (FRS 102). For the purposes of this report, the underlying operating position is calculated as the operating surplus/(deficit) adjusted for Universities Superannuation Scheme ‘credits’ and staff restructuring costs. It is recognised that institutions provide a separate analysis in their annual reports and accounts to explain the underlying surplus and this calculation may involve adjustments for other items e.g. some large capital grants, windfall income, non-cash pension costs etc. Not all institutions use the same basis for reporting and calculating the underlying operating position and a common methodology is currently in the process of being developed with the sector.
• However, the underlying position declines in the last two years of the forecast to £131.6 million in 2021-22 and £14.4 million in 2022-23. One-off cost savings generated during 2020-21 will not be repeated and staff and other operating expenses are expected to increase across the period reflecting a return to pre-COVID levels of activity with a return to full campus operations. The decline from 2020-21 can also be explained by the reduction in SFC grant and large capital receipts (e.g. City Deal income) which have no matching expenditure in the year of receipt. Subsequent years will reflect the cost of projects in the form of higher depreciation charges;

• While the additional funding made available to the university sector through COVID-19 support has helped to stabilise institutions’ finances, it is important to note that this is non-recurring funding;

• There continues to be significant variation between institutions in terms of their financial positions and performance that is not reflected in our aggregate indicators. The latest forecasts are skewed by the projections for three institutions which are projecting a combined underlying surplus of £237.8 million in 2020-21 with the remaining 15 institutions forecasting a combined deficit of £11.7 million;

• Ten institutions are expecting to report underlying operating deficits in 2020-21 albeit the levels of deficit, in general, are significantly reduced against previous returns. Eight institutions are forecasting underlying deficits in both 2021-22 and 2022-23;

• Institutions have highlighted inflationary cost pressures which are particularly impacting on capital projects while the rising cost of living is also increasing pressures in relation to pay settlements and energy costs;

• The forecast cash balance at the end of July 2021 is now £1.922 billion compared to the previous forecast of £1.769 billion. The sector position masks some particular challenges being encountered by individual institutions with 62% of cash balances being held by two institutions. The forecast cash reduces over the last two years of the forecast period reflecting the outlays on major capital programmes in the sector;

• Sector borrowing has increased significantly in recent years. However, the forecast at the end of July 2021 (£1.699 billion) is slightly less than that previously reported (£1.751 billion) which is largely attributable to an institution refinancing its student residences operation. Approximately half of the sector borrowing relates to two institutions. Institutions explored accessing UK Government COVID-related loan schemes but only one institution has drawn down from this source. The loan schemes are now closed to new applicants. Capital repayments will require the generation of surpluses and cash and this could be challenging given the expected multi-year impact of COVID-19. There is a risk that universities with large levels of borrowing are unable to build up sufficient cash reserves to make the repayments required at set points over the term of the borrowing; and

• The aggregated sector position masks varying degrees of challenges across all individual institutions.

**ACTIONS TO DATE**

The Financial Sustainability of Colleges and Universities in Scotland — Review Report, published in June 2021, set out details of actions taken to date in responding to the COVID-19 emergency in 2019-20 and 2020-21. These included:

- **BEING FLEXIBLE**
  - Not recovering SFC funds for shortfalls against core outcome agreement targets where these related to COVID-19 during 2020-21.

- **REDUCING REPORTING BURDENS**
  - Keeping returns and reporting requirements to a minimum.
PROVIDING ADDITIONAL FUNDS

• £75 million support for research;
• More funded SQA student places;
• UK Research and Innovation (UKRI) additional funding of £18 million to universities to support UKRI grant-funded research, research and technical staff and research infrastructures during the period of pandemic disruption, and £10.8 million relating to “change of use” from existing grant portfolios;
• Increased research capital for universities from World Class Labs funding scheme (£11.8 million in 2020-21);
• UK Government Coronavirus Job Retention Scheme income (£27 million in 2019-20; £13.9 million forecast for 2020-21);
• Funding for student mental health and wellbeing support (£612,000 in 2020-21);
• Funding for university student associations and unions (£329,000 in 2020-21);
• £9.7 million for income lost in student accommodation rebates, announced as part of a £30 million package of support for college and university students in hardship as a result of COVID-19;
• £35 million resource funding to help colleges and universities maintain research activity, protect jobs and help students;
• £20 million capital funding for research and knowledge exchange;
• £3.5 million additional capital funding to support economic recovery; and
• £2.4 million additional capital funding to support digital provision.

UNDERLYING OPERATING POSITION

The latest forecasts show a sector operating surplus of £224.3 million for 2020-21. The projections are impacted by the cost of Universities Superannuation Scheme (USS) net pension provision ‘credits’\(^4\) (£6.3 million) and exceptional staff restructuring costs (£8 million). Seven institutions expect to report exceptional staff restructuring costs in 2020-21.

In aggregate, after adjusting for USS ‘credits’ and staff restructuring costs, institutions expect to report an underlying operating surplus in 2020-21 of £226.1 million. The 2020-21 position is significantly improved on previously reported forecasts for that year.

At the time of writing, we have received some but not all institutions’ 2020-21 annual reports and accounts. We will issue an update on the actual results achieved in 2020-21 once all the accounts have been signed and submitted.

The impact of COVID-19 has not been as severe as initially predicted due to a combination of increased SFC grant (reflecting the additional non-recurrent COVID funding), international fee income, CJRS income, accelerated City Deal funding and a reduction in staff and other operating costs. While the additional funding made available to the university sector through COVID-19 support has helped to stabilise institutions’ finances, it is important to note that this is non-recurring funding. It is also important to note that one-off savings, arising from a freeze in recruitment and deferred capital spend together with reduced consumables budgets, will not be repeated. Filling staff vacancies and catching up deferred spend with a view to restoring the student experience will impact future surpluses.

Six institutions are showing a lower level of surplus for 2020-21 compared to the previous forecasts received in April. The sector underlying position continues to be a surplus, albeit significantly declining, in the last two years of the forecast as illustrated in the following graph:

Ten institutions expect to report underlying operating deficits in 2020-21 albeit the levels of deficit, in general, are significantly reduced against previous returns. Eight institutions are forecasting underlying deficits in both 2021-22 and 2022-23.

There is significant variation between universities in terms of their financial positions and performance that is not reflected in our aggregate indicators. The latest forecasts are skewed by the projections for three institutions which are projecting a combined underlying operating surplus of £237.8 million in 2020-21 with the remaining fifteen institutions forecasting a combined underlying operating deficit of £11.7 million as illustrated in the following table:

\(^4\) Universities’ commitments to fund USS deficit recovery contributions are reflected in their financial returns as a liability. This liability varies from year to year due to changes in the projected pensionable payroll but can also move significantly when there is a change in the level of recovery contributions. A revised set of contributions, arising from the USS 2018 valuation, was agreed in September 2019 and resulted in a decrease in institutions’ USS liabilities and ‘credits’ to the staff costs.
Table 1. Metrics Calculated

<table>
<thead>
<tr>
<th></th>
<th>2020-21 £ MILLION</th>
<th>2021-22 £ MILLION</th>
<th>2022-23 £ MILLION</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sum of underlying surpluses in three institutions</td>
<td>237.8</td>
<td>116.5</td>
<td>28.5</td>
</tr>
<tr>
<td>Sum of underlying surpluses in remaining institutions (number of institutions)</td>
<td>19.7 (five)</td>
<td>61.3 (seven)</td>
<td>14.0 (seven)</td>
</tr>
<tr>
<td>Sum of underlying deficits in remaining institutions (number of institutions)</td>
<td>31.4 (ten)</td>
<td>46.2 (eight)</td>
<td>28.1 (eight)</td>
</tr>
<tr>
<td>Total</td>
<td>226.1</td>
<td>131.6</td>
<td>14.4</td>
</tr>
</tbody>
</table>

The extent to which the forecasts are skewed by the ancient universities is illustrated in the following graph:

The graph below indicates the projected movement in categories of sector income over the forecast period.

**SOURCES OF INCOME**

**RELIANCE ON SFC GRANTS**

SFC grants are projected to increase to 31% of total sector income in 2020-21, reflecting the additional non-recurrent COVID-19 support funding provided in 2020-21 but institutions’ reliance on SFC grant is expected to reduce in the last two years due to the loss of non-recurrent COVID grants and forecast increases in other sources of income, particularly international fee income.

This demonstrates the planned recovery from the impact of COVID-19 by the sector, brought about by its predictions on generating income from international student fees and other non-government income.
TUITION FEES AND EDUCATION CONTRACTS

Tuition fee revenue represents the largest source of income for the sector. This source of income is forecast to increase from £1.400 billion in 2019-20 to £1.508 billion in 2020-21 and to £1.836 billion by 2022-23. In 2020-21, most institutions expect to report higher fee levels compared with 2019-20, however, a small number of institutions are reporting a decrease.

Overall tuition fees and education contracts are broken down into five categories as shown in the graph below:

The majority of institutions’ revenue from tuition fees and education contracts derives from international fees. There were initial concerns that this source of income would be severely impacted by the pandemic, however, the graph shows substantial increases in this source of revenue income which is expected to rise from £791.5 million in 2019-20 to £1,127.8 million in 2022-23. The increase demonstrates the sector’s planned recovery from COVID-19 and is expected to come from higher volumes, emerging markets and also increased fee levels.

While it is clear that institutions are becoming increasingly reliant on international fee income, the levels of growth achieved in recent years are unlikely to continue indefinitely and an increasingly competitive market may force institutions to adapt their business model. The established reputation of the ancient institutions means it is likely that they are better placed to withstand an increased level of competition, while chartered institutions may be more exposed to this risk. In general, modern (post 1992) and small specialist institutions are less reliant on this source of income but will also need to adapt their business model in the face of increased international competition.

RESEARCH GRANTS AND CONTRACTS

Institutions have experienced disruption to research activities during COVID-19 due to reduced access to campus facilities. Research income amounted to £791.1 million in 2019-20, down £24.7 million from 2018-19, but is expected to recover to £810.2 million in 2020-21 and then increase to £859.2 million in 2021-22 and £908.2 million in 2022-23. In the final year, approximately 69% of the income from this source is generated in three institutions. The breakdown of research and contracts income is shown below:

While the majority of institutions are forecasting increases in international fee income, the most significant growth comes from the larger ancient and chartered universities.

Fee income from Scottish students is expected to increase from £265.8 million in 2019-20 to £357 million in 2022-23, despite the unit of resource per Scottish student being frozen for several years, while fee income from EU students is forecast to reduce from £75.6 million to £51.8 million over the same timeframe.

Fees from the rest of the UK (RUK) students show small increases over the forecast period, rising from £175.7 million in 2019-20 to £187.4 million by 2022-23. This may be an area of risk for those institutions which have relatively more reliance on RUK students and may be impacted more significantly by changes in English higher education policy.
OTHER INCOME

While international fee income has to date been largely unaffected by the pandemic, the same cannot be said for income from student residences, catering and conference activity. Virtually all institutions experienced a substantial reduction in income from this source in 2019-20 and particularly in 2020-21 against pre-COVID levels. Ancient and chartered institutions have been impacted the most. Institutions generated £253.8 million from residences, catering and conference revenues in 2018-19, reducing to £205.5 million in 2019-20 and £135.0 million in 2020-21. In general, the forecasts show a gradual build-up of this income and indicate a return to pre-COVID levels in 2022-23.

The majority of institutions continued to take advantage of CJRS income during 2020-21 and this accounted for £13.9 million of income. City Deal funding accounted for £65.4 million of income in 2020-21 and is forecast at £23.9 million in 2021-22 and £12.9 million in 2022-23. Other income generating activities were considerably higher in 2020-21 due to additional income from laboratory testing and, in 2021-22, due to large one-off capital grant receipts.

EXPENDITURE

The graph below shows a forecast of expenditure by category:

STAFF COSTS

The increase in staff costs across the forecast period reflects assumed pay awards after 2020-21, incremental drift and also increased pension costs. Many institutions operated a freeze on non-essential recruitment during the COVID lockdown but this represented a one-off saving and staff costs are expected to increase as vacancies are filled and activity returns to pre-COVID levels while institutions are also making strategic staffing investments to support future growth.

Staff costs as a percentage of total expenditure are forecast at 57% for 2020-21 reducing to 56% for the following two years. The percentages for 2018-19 and 2019-20 were skewed by USS pension adjustments.
The graph below shows the increases in annual contributions to the various university pension schemes.

<table>
<thead>
<tr>
<th>University sector annual contributions to pension schemes (£000)</th>
</tr>
</thead>
<tbody>
<tr>
<td>USS</td>
</tr>
<tr>
<td>0</td>
</tr>
<tr>
<td>100,000</td>
</tr>
</tbody>
</table>

It is anticipated that there will be significant increases in pension costs in future years particularly in the Universities Superannuation Scheme (USS) which collects the bulk of employer contributions. For the USS scheme, the majority of institutions had assumed an increase from 21.1% to 23.7% in October 2021 based on the rates scheduled under the most recent agreed valuation (2018). However, on 6 September 2021, the USS Joint Negotiating Committee proposed new contribution rates which, although subject to consultation, would mean an increase in employer contributions of 0.3% to 21.4%. This proposal also included changes to member benefits to ensure the scheme is sustainable in the long-term.

The proposed changes to the scheme have resulted in institutions’ staff taking industrial action across the UK. In Scotland, staff at the universities of Dundee, Edinburgh, Glasgow, Heriot-Watt and Stirling took industrial action.

If the USS proposals are accepted, there will be a reduced cost to institutions but this will, to some extent, be balanced by the proposed 1.25% increase to employer National Insurance contributions from 6 April 2022. The estimated annual cost of the additional National Insurance contributions across the sector is expected to exceed £24 million.

Other operating expenses are forecast to increase across the period reflecting a return to pre-COVID levels of activity with a return to full campus operations.

INFLATIONARY COST PRESSURES

Institutions have highlighted inflationary cost pressures in their latest financial forecast returns. In particular, these are impacting on construction projects where reduced manufacturing capacity, freight delays, Brexit legislation, and fragmented global supply chains have all contributed to pushing up costs and tightening supply chains. The rising cost of living is also increasing pressures in relation to pay settlements while energy costs are also expected to increase sharply.

CASH AND EQUIVALENT BALANCES

The graph below shows the trend in the main cash performance indicators for the university sector from 2014-15 to 2022-23.

The forecast cash balance at the end of July 2021 is now £1.922 billion compared to the previous forecast of £1.769 billion, in line with the improved operating position. The forecast cash balance is expected to reduce over the last two years of the forecast period reflecting the outlays on major capital programmes in the sector many of which were delayed during 2020-21. Cash balances and number of days expenditure held in cash reserves are key performance indicators.
The sector position masks some particular challenges being encountered by individual institutions with 62% of cash balances being held by two institutions and the cash levels held vary considerably across the sector with the number of days expenditure held in cash varying from 59 days to 275 days in 2020-21. Anything less than 60 days may raise concerns, particularly if the institution is encountering other financial challenges.

Maintaining short-term liquidity is critical and institutions’ focus during the COVID-19 pandemic has been on protecting cash reserves and thereby their ability to absorb short term operational deficits. Several institutions have agreed overdraft or revolving credit facilities with lenders to provide additional headroom.

**NET CASH INFLOW FROM OPERATING ACTIVITIES**

Three institutions expect to report a net cash outflow from operating activities during 2020-21 and this is forecast to reduce to two institutions in each of the later years. Overall, cash generated from operations in the sector is forecast at £340.4 million in 2020-21, £302.3 million in 2021-22 and £264.3 million in 2022-23. Across all institutions, the sector net cash inflow from operating activities as a proportion of total income is expected to reduce from 7.8% in 2020-21 to 6.5% in 2021-22 and 5.6% in 2022-23.

**BORROWING**

The graph below shows the trend in levels of sector borrowing over the period 2014-15 to 2022-23.

Total long-term borrowing is forecast to decrease from £1.731 billion at the end of July 2020 to £1.699 billion at the end of July 2021. Seven institutions increased their debt but this was offset by reductions in other institutions as a result of repayment of traditional loan debt by instalments, repayment of some short-term debt taken out in response to COVID-19 impacts and refinancing of an institution’s residence operation. Four institutions are forecasting an increase in bank loan debt over the last two forecast years and total sector debt of £1.709 billion is projected at the end of July 2023 of which £141.2 million relates to Financial Transactions.

Sector borrowing has been increasing since 2014-15 and has increased significantly in recent years. The majority of the sector borrowing relates to two institutions which account for 50% of the sector total by value at the end of July 2021. The increase in borrowing since 2018-19 largely relates to the chartered institutions. Institutions have explored accessing UK
Government COVID-related loan schemes during the pandemic but only one institution has drawn down from this source. The Government loan schemes are now closed to new applicants.

Capital repayments require the generation of surpluses and cash and this could be challenging given the expected multi-year impact of COVID-19. There is a risk that institutions with large levels of borrowing are unable to build up sufficient cash reserves to make the repayments required at set points over the term of the borrowing in relation to Private Placements. It is also anticipated that the cost of borrowing will increase over the short to medium-term as interest rates are increased to curb wider inflationary pressures.

No covenant breaches are forecast although in some cases it has been necessary for institutions to re-negotiate covenant terms in light of COVID-19. Institutions have provided assurances that they are engaging on a regular basis with lenders and keeping them fully appraised.

It is possible that banks will adopt a more cautious approach to lending to institutions in future. Many institutions are not currently in a position to commit to future borrowing and are currently reassessing estates development programmes. Environmental sustainability conditions are also likely to be incorporated in future lending agreements.

**MITIGATING ACTIONS**

Institutions reacted rapidly to the COVID-19 crisis and undertook a variety of measures to mitigate the impact of COVID-19 on their operations. On the cost side, this included restructuring (seven institutions included staff restructuring costs in their 2020-21 forecasts). Other measures included vacancy management and mission critical only recruitment, freezing non-essential spend, delaying capital spend, taking advantage of VAT payment deferral schemes and renegotiating payment plans with suppliers.

In order to protect income levels, institutions are continuing to expand digital delivery and develop new overseas markets and partnerships as well as focus on income-generating opportunities at home (e.g. better utilisation of residences in the summer break).

Institutions’ latest forecasts, along with additional financial returns over the coming months, will continue to further develop our understanding of COVID-19 impacts on individual institutions and the overall sector, and enable provision of further advice to Scottish Government.

**KEY RISKS**

The most significant risk areas for universities that could adversely affect their financial performance and sustainability relate to:

- The continuing impact of the COVID-19 pandemic, required public health restrictions that affect Scotland’s competitive position, and the potential failure to achieve international student recruitment targets within a more competitive global market;
- Rise in staff costs including increases in employers’ pension contributions, the Universities Superannuation Scheme in particular and industrial action;
- Stock market pressures and wider economic challenges that lead to significant drops in regular donations and income from endowments;
- Existing debt levels and the management of lender and private placement relationships and compliance with covenants;
- Future arrangements for funding Graduate Apprenticeships;
- Fall in rUK recruitment in an increasingly competitive market;
- Changes in UK Government policy on higher education.
- UK policy relating to visa and immigration regulations; wider international policies, including mobility and exchange schemes; and the development of policy designed to mitigate the effects of leaving the EU, in particular the development of the Shared Prosperity Fund;
- Unanticipated public spending cuts in teaching and/or research income;
- Impact of changes to UK research funding, and the research funding policies of charities and industry; and
- Failure to effectively manage major capital investment programmes and their financial impacts.