
FINANCIAL SUSTAINABILITY OF THE UNIVERSITY SECTOR: ANALYSIS OF 2023 STRATEGIC PLAN FORECAST RETURNS

PURPOSE

1. The purpose of this paper is to report on the current financial sustainability of the university sector based on an analysis of the 2023 Strategic Plan Forecast returns covering the years 2022-23 to 2024-25. The forecasts were received at the end of June 2023.

RECOMMENDATIONS

2. The Finance Committee is invited to note and comment on the university sector's 2023 Strategic Plan Forecast returns and the updated assessment of institutions' financial sustainability.

FINANCIAL IMPLICATIONS

3. There are no specific programme fund or running cost implications arising from this paper that are not already allowed for in the Council's programme fund or running cost budgets.

RISK ASSESSMENT

4. There is a risk to the achievement of the Council's strategic plan priorities and/or a risk of reputational damage from failures in university governance, leadership, and management, including financial failure.
5. This risk is mitigated by regular monitoring of institutions and any universities facing heightened challenges to their sustainability are subject to a higher level of engagement.
6. Overall, for the university sector, the Executive's assessment of this risk is high.

IMPACT ASSESSMENTS

Equality and diversity

7. There are no equality and diversity issues associated with this paper.

Island communities

8. The recommendations in this paper do not have an impact on island communities.

Carbon reduction

9. There are no carbon reduction issues associated with this paper.

PUBLICATION

10. This paper will be published on the Council website in edited format (to remove references to specific institutions or forecast information) as it includes information which, if disclosed, would be prejudicial to the effective conduct of affairs (Freedom of Information (Scotland) Act 2002, Section 30).

FURTHER INFORMATION

11. Contact: Andrew Millar, Assistant Director Institutional Sustainability and Governance, or Claire Taylor, Senior Financial Analyst.

FINANCIAL SUSTAINABILITY OF THE UNIVERSITY SECTOR: ANALYSIS OF 2023 STRATEGIC PLAN FORECAST RETURNS

PURPOSE

12. The purpose of this paper is to report on the current financial sustainability of the university sector based on an analysis of the 2023 Strategic Plan Forecast returns covering the academic years 2022-23 to 2024-25. The forecasts were received at the end of June 2023.

BACKGROUND

13. Institutions submit the following financial returns to the Scottish Funding Council (SFC) during the Academic Year (AY):
 - Financial Forecast Update (FFU) at the end of March for continued monitoring of the forecast outturn for the current AY;
 - Strategic Plan Forecast (SPF) at the end of June, comprising an outturn forecast for the current AY and forecasts for the following two AYs;
 - Annual accounts at the end of December, comprising the audited financial statements for the AY and supporting audit reports by the institutions' audit committees, internal and external auditors; and
 - Quarterly and monthly returns for institutions experiencing heightened challenges to their ongoing financial sustainability.
14. This paper reports on the executive's analysis of the 2023 SPFs submitted at the end of June, comprising an outturn forecast for 2022-23 and forecasts for the following two years.

STRUCTURE OF PAPER

15. The paper comprises key messages, key risks, mitigating actions and next steps. The paper is supported by five annexes:
 - **Annex A:** Detailed analysis of 2023 Strategic Plan Forecast returns;
 - **Annex B:** Summary of institutions' operating and underlying operating position, liquidity and borrowing;

- **Annex C:** Engagement framework including rationale for the categorisation of institutions' engagement assessment and financial update;
- **Annex D:** University Private Placement capital repayment profile – position as reported in 2021-22 accounts; and
- **Annex E:** Updated structure of the University of Highlands and Islands.

KEY MESSAGES FROM OUR ANALYSIS OF INSTITUTIONS' 2023 STRATEGIC PLAN FORECAST RETURNS

- **The sector is forecasting an underlying operating surplus of £226.5m for AY 2022-23.** This represents a reduction on the previous year's underlying surplus of £385.2m (41% reduction) largely due to increased staff costs. Although the university sector reports surpluses, this can paint a misleading picture of the sector's overall financial position, which remains challenging.
- **The underlying position is expected to decline sharply to a deficit of £3.3m in 2023-24 before partly recovering to a surplus of £44m in 2024-25.** The downturn against 2022-23 levels is due to significant increases in staff pay, utilities and other operating costs, and depreciation combined with a reduction in SFC funding, other income (including: European income; City Deal funding; and capital grants received), and donations and endowments. The university sector takes a cautious approach to forecasting and in recent years the actual results are much improved on earlier projections.
- **Financial sustainability remains challenging for many institutions.** The sector position in 2022-23 is skewed by the forecasts of the two largest institutions which are forecasting a combined surplus of £164m (72% of the sector total). Between six and ten institutions are forecasting underlying operating deficits in each of the three years. The forecast is also inflated by the receipt of substantial capital grant funding with matching expenditure expected to fall into future years.
- **Tuition fee revenue represents the largest source of income for the sector. Levels of international fee income have increased sharply in recent years and the forecasts confirm that trend is expected to continue.** International fee income is expected to increase from £1,144m in 2021-22 to £1,289m in 2022-23 and £1,617m by 2024-25, a 41% increase on 2021-22. Institutions need this source of income to remain financially sustainable and to support other areas of their operation such as research which can be a loss-making activity. International tuition fee income continues to be an area of significant fluctuation and risk due to the competitive nature of the international markets and geopolitical changes.

- **The top five countries for international students at Scottish institutions in 2022-23 were: China, India, Nigeria, USA, and Pakistan in that order.** Institutions reported growth in international recruitment from all these countries in 2022-23 except for China (3% reduction). The highest growth is from Pakistan and Nigeria at 91% and 86% respectively. A total of 62% of international students (48,799 students out of a total international intake of 78,305) are studying at postgraduate level.
- **The sector cash position is forecast to increase by 5% from £2,259m at the end of July 2022 to £2,371m by the end of July 2023.** This reflects the improved operating position, changed timetables in implementing capital programmes and additional loans drawn down but not fully utilised. Cash reserves are expected to decline after 2022-23 reducing to £1,791m by the end of July 2025 (24% reduction). This is mainly due to the expected outlays on major capital programmes put on hold during the pandemic. No institution is forecasting a cash deficit throughout the forecast period, but a large proportion of cash is restricted for other purposes. This includes repayments of high debt levels, meeting debt covenants and capital projects for which ring-fenced funding had already been received.
- **Sector borrowing is forecast to decrease by 3% from £1,656m at the end of July 2022 to £1,613m at the end of July 2025.** Most of the sector's borrowing is now in the form of Private Placements which involve large bullet payments at set points in the future with interest paid in the intervening years. No bank covenant breaches are expected over the planning period.
- **It is important to note that:**
 - **the sector is not homogenous** and there continues to be variation between institutions in terms of financial performance that is not reflected in the aggregate indicators.
 - **the returns are forecasts and are not a guarantee of future performance and are highly likely to change over the planning period.**
- Institutions are due to provide their annual accounts for 2022-23 at the end of December 2023 and our analysis of these returns will be reported to the Committee in early 2024.

KEY RISKS FOR UNIVERSITIES

16. The institutions identified several risks in their returns which could adversely affect their financial health and ability to achieve student activity and other income targets. The most significant risk areas for institutions relate to:
 - **Over-reliance on income from international students to remain financially sustainable** and support other areas of their operations, particularly where

recruitment is heavily weighted to a single country, and changes to UK policy relating to **visa and immigration regulations**;

- **Macro-economic outlook** is uncertain with inflation reducing but remaining high by historic standards, and rising interest rates;
- **Increasing staff costs** due to cost of living pay awards and increases in employer contributions to some pension schemes;
- **Rising energy costs** with the centrally negotiated contract for university energy costs ending across 2022-23 to 2023-24 with universities moving onto a new contract. Changes to government support are also proposed for 2023-24 which are likely to make this support less generous;
- Having **adequate infrastructure in both institutions and the wider community for the increasing levels of international students** e.g. shortage of student accommodation may result in prospective students having to decline or defer places offered by institutions;
- Stock market pressures and wider economic challenges that lead to significant drops in regular **donations and income from endowments**;
- Existing **debt levels**, high interest rates and the management of lender and Private Placement relationships, including compliance with covenants;
- The uncertainty of the **UK Government's policies** on Higher Education, including those designed to mitigate the effects of leaving the EU, and which may also impact **rUK recruitment** in an increasingly competitive market;
- Unanticipated **public spending cuts in teaching and/or research income**. Further in-year reductions would put significant added pressure on institutions to maintain a sustainable trajectory;
- The impact of the outcome of the **Independent Review of Skills Delivery and Purpose and Principles** on the sector as the Scottish Government continues to develop its response;
- The requirement for universities to **invest in the achievement of public sector net zero targets** with the costs across the UK HE sector recently estimated at £37.1bn¹;
- Impact of **changes to UK research funding** and the research funding policies of charities and industry;
- The impact of **reinforced autoclaved aerated concrete (RAAC)** on the university estate with potential building closures and expenditure required to make affected buildings safe for use; and

¹ [The Cost of Net Zero | EAUC](#)

- **Failure to effectively manage major capital investment programmes** and their financial impacts, including construction inflation.

MITIGATING ACTIONS

17. 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. In a 'flat cash' resource budget for the sector, SFC has adjusted its funding model which enabled us to raise the teaching subject prices by 0.5% and strengthen the world-renowned small specialist institutions.
18. On the cost side, mitigations include staff restructuring and not filling vacancies or removing posts, freezing non-essential spend, undertaking cost benchmarking exercises, reviewing course portfolios, delaying capital spend and reviewing estates strategies to ensure estates are used more efficiently.
19. It is important that institutions continue to adapt to specific challenges and other uncertainties. Financial challenges will affect individual institutions in different ways and each institution will have its own range of mitigating actions available. We expect institutions to be alert to the risks to their financial health and have contingency arrangements in place to address them. We encourage institutions to constantly review and consider the range of options available to them so they can take corrective action rapidly as and when risks begin to emerge.

NEXT STEPS

20. SFC does not have any definitive information on future years' budgets beyond 2023-24. SFC will continue to provide advice to Scottish Government on the financial sustainability of the sector and engage appropriately in the Spending Review process.
21. Given continuing pressures on Scottish Government budgets, SFC may be asked to look for further in-year savings in university budgets with an adverse impact on the availability of funding to the sector.
22. SFC is continuing to request regular financial returns from institutions. Whilst reasons for sustainability issues at individual institutions vary, it is important for SFC to understand and track appropriate financial health indicators which can affect the success of institutions and the sector overall. Institutions are due to provide their annual accounts for 2022-23 at the end of December 2023 and our analysis of these returns will be reported to the Committee in early 2024. SFC will continue to engage closely with particularly vulnerable institutions in addressing financial health challenges.

RECOMMENDATIONS

23. The Finance Committee is invited to note and comment on the university sector's 2023 Strategic Plan Forecast returns and the updated assessment of institutions' financial sustainability.

{Annex A-D}