



ASSOCIATION  
OF COLLEGES

# AoC 2018 report on college finances

14 September 2018

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Association of Colleges

September 2018

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## Introduction

1. There are 266 colleges in England<sup>i</sup> and they are under serious financial pressure. The outlook for the sector has deteriorated in the last 12 months despite funds made available in recent Treasury budgets and despite the widespread agreement that education and skills matter for the country's future.
2. The immediate financial issues for colleges are:
  - **Falling income from 16-to-18-year-olds** Education of 16-to-18-year-olds account for 41% of FE college income and 77% of sixth form college income<sup>ii</sup>. This income is falling because there are fewer 16 to 18 year olds in the population and falling numbers staying in education<sup>iii</sup>. DfE funding for 16 to 18 education in colleges will fall by 2.1% in 2018-19 because the autumn 2017 census reported a 2.4% fall in student numbers<sup>iv</sup>.
  - **Apprenticeship challenges:** Apprenticeships accounted for 10% of total FE college income in 2016-17. Despite expectations of higher apprenticeship income, the numbers starting apprentices in 2017-18 has fallen and actual spending has been well below expectations.<sup>v</sup> Colleges expect apprenticeship income to fall in 2018-19 compared to 2017-18<sup>vi</sup>
  - **Unavoidable pay costs.** Staff costs account for 65% of FE college and 71% of sixth form college income in 2016-17. This is above the FE commissioner benchmark of 63% and which reflects the pressure to keep pay competitive and higher social costs.
  - **Refusal of the government to cover inflation.** The Consumer Price Index has risen by 7% in the last five years and is expected to rise by 4% between now and 2020<sup>vii</sup> but the funding rates paid to colleges have been fixed in terms of cash since 2013. DfE has found money from its budget to protect funding per school pupil and to support pay increases but there is nothing similar to protect colleges or post-16 education.
  - **Withdrawal of finance.** Colleges are able to borrow but for the last three years the sector has been paying back more to the banks than they are taking out. Total college debt fell from £1.5 billion in July 2015 to £1.25 billion in 2016-17. The banks have become very cautious as a result of the new college insolvency laws<sup>viii</sup> and DfE plan to remove exceptional financial support where colleges run out of cash.
3. This report uses publicly available data to analyse these issues in more detail.

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## Introduction

1. The purpose of this report is to document and explain some of the financial issues facing colleges in England using 2016-17 financial statements data that is collected by the Education and Skills Funding Agency (ESFA) and made available via a large spreadsheet<sup>ix</sup>. Two reports provide a model for this document. These are the reports produced by officials on English universities<sup>x</sup> or Scottish colleges<sup>xi</sup> which also use data from 2016-17 accounts to explore sector-wide trends. AoC represents colleges and is not a regulator but we work closely with government to ensure colleges are financially sustainable and able to meet national objectives. This report aims to be fair and balanced. A note also on numbers. 304 colleges provided accounts data for 2016-17 but there is extensive structural change underway. There were 29 college-to-college mergers in 2017 and 20 sixth form college conversions to become 16-19 academies. There have been more mergers in early 2018. At the time of writing there are 266 college corporations<sup>xii</sup>. The changing number of colleges means that some of the year-on-year comparisons are not as precise as they might be but they have been included to explain trends.

## Education spending in England

2. The entire English education system faces financial problems. Crisis is an over-used word to describe this but there is a serious mismatch between expectations, costs and resources. The root of the problem in state-funded education is public spending restraint at a time when demand and need is rising. Some bigger policy decisions shape the DfE budget:
  - **Total education spending falling as a share of GDP.** Public spending on education as a share of GDP is expected to fall from 4.4% in 2016-17 to 3.9% by 2021-22<sup>xiii</sup>. OBR predicts spending will stay below 4% of GDP throughout the 2020s. During the early years of the 2000s, spending was 5% of GDP and rose during the financial crisis to a peak at 5.8%. Some of the difference is explained by the increase in higher education (HE) tuition fees and the introduction of the student loan scheme<sup>xiv</sup> but a significant explanation of the change has been the squeeze in spending at a time when the core school population is forecast to rise by 500,000 to 7 million (an 8% increase)<sup>xv</sup>.
  - **Use of student loans and the levy to fund spending:** The UK government has introduced two forms of user charging in education. In 2011-12, the government spent £5 billion on higher education teaching, £3 billion on maintenance grants and £1.5 billion on apprenticeships. From 2017-18, this spending is almost entirely covered by student loans and the apprenticeship levy.
  - **The school budget ringfence.** Ministers have protected school budgets in various ways since 2010 with the result that the core school budget will rise

by 24% over the decade (from £35 billion in 2010-11 to £43.5 billion in 2020-21). The decisions to protect school budgets have resulted in larger cuts in non-school budgets in successive spending reviews (2010, 2013 and 2015). Education Maintenance Allowances ended in 2011-12. Funding per 16-18 student was reduced in stages between 2011 and 2015 then fixed in cash terms (at £4,000 per full-time student). The funding rate for 18-year-olds was cut by 17.5% in 2014-15. Adult education budgets were reduced each year between 2009-10 and 2015-16 and then fixed in cash terms.

## Department for Education protection for schools

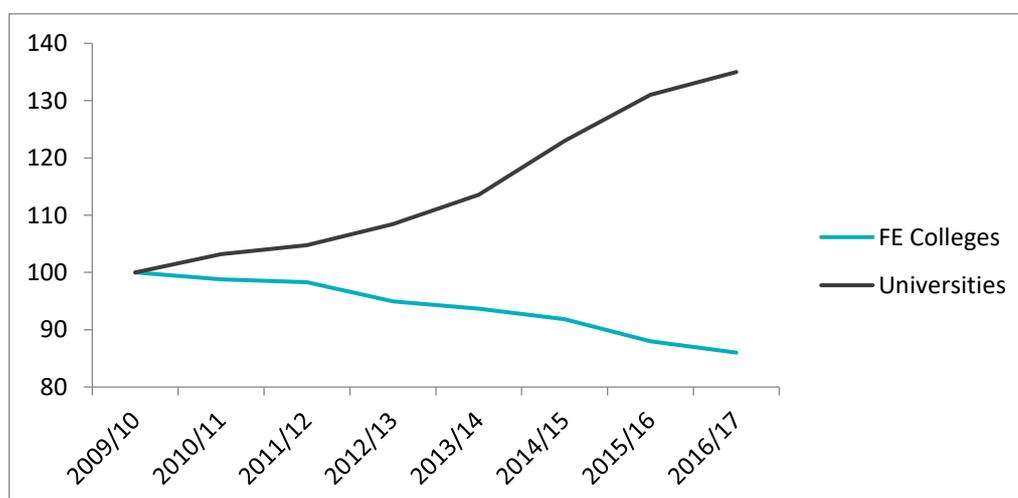
3. When it comes to spending decisions in education, the school budget takes priority and everything else is detail. In 2018-19, DfE has a revenue departmental expenditure limit of £65 billion, of which £50 billion will be paid in school grants and £5 billion on standards, curriculum and qualifications which are mainly school related. £4.3 billion of DfE's capital departmental expenditure limit of £5.1 billion is spent on schools<sup>xvi</sup>. The Treasury and DfE has ringfenced the schools budget since 2010 and protected it from cuts applied to other parts of education. From 2010, protection has involved ensuring that cash funding per pupil does not fall and taking steps towards a national school funding formula while minimising the losses for schools whose funding levels are currently above the national calculation. In recent school budget decisions, DfE promised an average 3.1% rise in per pupil spending in both 2019-20 and 2020-21 with school-level increases ranging from 0.5% to 6% depending on national and local formulae<sup>xvii</sup>. On top of this, DfE ministers recently promised an additional grant to schools to fund pay increases for teachers ranging from 1.5% to 3.5% in 2018-19.
4. DfE was only constituted in its current form in 2016 following Theresa May's first cabinet reshuffle. When she appointed Justine Greening as Education Secretary, she also extended DfE's role to include further education, apprenticeships, higher education (but not research). DfE and its agencies now oversee a very large number of schools, colleges, universities, nurseries and training providers. There are big differences in the way that DfE funds, supports and intervenes in different parts of the system but the net effect is a degree of protection for schools which does not extend to colleges or other education institutions:
  - **Protection of school budgets.** DfE has repeatedly protected school budgets since 2010. The current promise is that every school will get a minimum annual 1% increase in cash funding per pupil and that there will be a minimum level of funding per student (£4,800 per secondary pupil by 2019-20).
  - **Capital funding.** Access to capital grants for new school places, school rebuilding, condition improvement and maintenance. This is worth a total of £4.3 billion in 2018-19 compared to £0.2 billion for college capital spending<sup>xviii</sup>

- **Cashflow.** Revenue grants to schools are paid in 12 equal instalments on the first day of the month whereas grants to colleges are cut each spring which results in a cumulative 6% underfunding each March. Academies in financial trouble can access interest-free advances (of general annual grant)
- **VAT refunds.** VAT refunded on supplies and services is worth an estimated 2% of income to schools (perhaps £1 billion). DfE does not adjust funding to take account of the different VAT status of institutions.
- **Business rates, insurance and other costs.** DfE fully funds business rates whereas colleges and other charities pay 20%. The Department runs a self-insurance scheme for schools (Risk Protection Assurance), guarantees academy LGPS debts and underwrites network services to schools (whereas universities and, from 2019, colleges will pay for these via JISC). DfE centrally negotiates copyright and software licence deals for schools only.

## Universities, the post 18 review and student loans

5. The English university system is built on a residential, full-time model with students taking three years to get a degree. Fees for all types of full-time course have risen towards the £9,250 cap. Even once access agreement costs have been deducted, this is significantly above the income received by universities from fees and HEFCE grants in 2011-12. The existence of student loans has protected higher education from many of the spending cuts which have reduced resources in other public funded activities in England since 2009. In addition to teaching income, universities have significant income from research grants and contracts, from international students and from other income-generating activities. The chart below reports the total income for universities in England indexed to 2009 compared to the total income for colleges.

CHART ONE UNIVERSITY AND COLLEGE INCOME, INDEXED TO 2009



6. Student loans have been used to fund education since 1990 but are now a substantial factor in the education budget. Government cash spending on new student loans will be £18.2 billion in 2018-19. With £2.6 billion in repayments expected, this means that new student loan outlays will be £15.6 billion. Student loans cover tuition fees and maintenance and attract interest. Accrued student loan interest income in 2018-19 is £4.7 billion. The government does not expect to collect the full value of student loans from all borrowers. DfE records a Resource and Accounting Budgeting (RAB) charge in its accounts to record the proportion of loan repayments expected not to be repaid when repayments are valued in present terms. The RAB charge for full-time HE students is 40%, for part-time HE students is 45% and for advanced learner loans is 50%<sup>xix</sup>. Although this charge is made in DfE's accounts, there is no impairment recorded in the main public finance statements. Whereas teaching and maintenance grants count against the public sector net debt, student loans do not.
7. The Office for National Statistics is currently reviewing the accounting treatment for student loans and is due to report in December 2018. This follows criticism by the House of Commons Treasury Committee and House of Lords Economic Affairs Committee. Both committees argue that the accounting treatment for student loans is not correct while at the same time producing a flattering picture of the true state of the public finances. Both committees say that the favourable accounting treatment has resulted in a bias towards using student loans to fund higher education. ONS's review might change this but there are a variety of possible alternatives. The Office of Budget Responsibility (OBR) published a paper in July 2018 setting out four possible alternative accounting treatments, all of which would involve a substantial charge to government expenditure<sup>xx</sup>. Three of the four approaches examined by OBR would add £15 billion or more to the government's reported deficit for 2018-19<sup>xxi</sup>. It is unclear now what the implications of such a large revision would be but they might, at the very least, prompt a return to some form of student number controls for higher education.

## The teacher pension scheme

8. The Teacher Pension Scheme (TPS) pays pensions to retired teachers and takes contributions from 650,000 teachers in schools, colleges, post-1992 universities and private schools. TPS is an unfunded public sector scheme and is now governed by rules set out in the 2013 Public Service Pension Act. This Act brought into effect the Coalition government's public sector pension reforms which included a shift from final salary to career average pensions for post-2015 service, substantial protection of existing final salary entitlements, changes to indexation and higher contributions for employees (up from 6.4% to an average of 9.6%). The new scheme took effect in 2015 in the same year as an increase in the employer contributions from 14.1% to 16.48%. Contribution rates are set following four-yearly valuations carried out by the Government Actuary. The actuary will complete the next valuation in autumn 2018 and the signs are that there will be a

substantial increase in the employer contribution – perhaps to 21%. Every extra percentage point will cost TPS employers £250 million and colleges £20 million. DfE officials say that there will be funded for academies, maintained schools and colleges for the period covered by the current spending review period but this only lasts until March 2020. Future funding depends on the next spending review.

## Department for education spending on post 16 education

9. In a recent report on education spending, the Institute of Fiscal Studies comment that spending on further education has been the “only major area of education spending to see cuts since 2010”. IFS focus their attention on spending per student or pupil but explain that government has protected funding per school pupil, has increased the early years budget and has used student loans to enhance the resources available in higher education. Another way of looking at the further education budget is to look at the budgets covered by the former Learning and Skills Council. This was established in 2001 and had responsibility for spending on all types of 16-to-18 education, adult education and apprenticeships. In its first years, its total budget was more than £10 billion. The LSC is long gone but the activities it funded still exist and now account for £8.3 billion in spending. There has been an absolute reduction in spending on post-16 education outside HE over 15 years.
10. It is difficult to track spending on education because of there are three official sources of information:
  - **DfE's budget.** DfE's estimates<sup>xxii</sup> cover government financial years (April to March) and is at an aggregated level linked to Parliamentary votes. The most recent data covers the 12 months from April 2018 to March 2019.
  - **ESFA funding allocations.** ESFA publishes individual funding allocations against detailed budget lines covering academic years. The most recent publications covers the 12 months from August 2017 to July 2018.
  - **DfE and ESFA financial statements.** The latest set of accounts cover the 2017-18 financial year and were published in July 2018<sup>xxiii</sup>.
11. The table below reports actual spending in the 2017-18 and 2016-17 financial years on various 16+ budgets.

TABLE ONE: DFE SPENDING ON 16+ AND FURTHER EDUCATION BUDGETS

DFE spending, financial year		2017-18 £ millions	2016-17 £ millions	Change
16-18 grants to schools	a	2,096	2,129	-1.6%
16-18 grants to colleges	b	3,581	3,661	-2.2%
16-18 bursary	c	158	167	-5.4%
16-18 apprenticeships	d	745	815	-8.6%
Adult apprenticeships	e	951	839	+4.1%
Funding to support apprenticeships	f	21	-	
Adult education budget	g	1,453	1,351	+7.5%
European funding	h	202	50	
Other current grants FE/HE	j	69	207	
<b>DFE 16-18 spending (a-d)</b>		<b>6,580</b>	<b>6,772</b>	<b>-2.9%</b>
<b>DFE apprenticeship spending (d-f)</b>		<b>1,717</b>	<b>1,654</b>	<b>+3.8%</b>
<b>DFE 16+ FE revenue spending (a-j)</b>		<b>8,307</b>	<b>8,380</b>	<b>-0.9%</b>

## 12. Key spending trends:

- 16 to 18 spending on schools and colleges.** Total DfE spending has been falling every year in cash terms since it reached a peak of £7.7 billion at the start of the decade (2010-11). In a recent report on education spending trends, IFS calculate that 16-to-18 spending per student fell by 7% in real-terms between 2010-11 and 2015-16 and will fall by another 6% between 2015-16 and 2019-20. By the end of the decade, IFS estimate that spending per 16-to-18 student will be no higher than 30 years ago<sup>xxiv</sup>.
- Apprenticeship spending.** Government spending on apprenticeships rose from £1 billion at the start of the decade (2010-11) to £1.5 billion in the middle (2015-16) and is due to rise above £2 billion as a result of the levy but effectively stalled in 2017-18.
- Adult education budget spending.** Government spending on adult education outside apprenticeships and offender learning fell from £2.8 billion at the start of the decade (2010-11) to below £1.4 billion in the middle (2015-16)<sup>xxv</sup>. This is part of a longer cutback which has seen the number of adult students has fallen by 1.1 million between 2006 and 2016 (from 2.7 million to 1.6 million) at a time when the population of England has risen by 4 million from 53 to 57 million<sup>xxvi</sup>. Community-based adult education provision has largely disappeared in recent years. The government promised to protect the budget at £1.5 billion but this is a cut in real-terms and there have been underspends of varying amounts in the last three years. The devolution of half of the adult education budget to mayoral combined authorities in 2019 brings new uncertainty.

## Further education funding now and in future

13. Education and Skills Funding Agency (ESFA) oversees all of this spending but using different systems and formulae:

- **16 to 18 funding formula.** ESFA pays grants to the 266 colleges and to more than 2,000 schools with sixth forms via a single national formula which multiplies the number of students enrolled in the previous year by a weighted average calculation based on their characteristics. The national funding rate for full-time 16-and-17-year-olds in all types of providers is £4,000 and the rate for full-time 18 year-olds is £3,300. Uplifts worth a total of £960 million<sup>xxvii</sup> (about 15% of total funding) pay for extra support for disadvantaged young people; courses that cost more to deliver; areas of the country where delivery costs are higher; and costs of the largest courses. ESFA also allocates around £100 million in 16 to 18 bursary funds to colleges to spent supporting students. In 2018-19, ESFA also allocated the first slice of technical education funds – £53 million to fund industry placements.
- **Apprenticeship formula.** ESFA now pays for apprenticeship training via new funding formula introduced in 2017. The new formula only applies to apprentices who started after 1 May 2017. Several different legacy formulae cover apprentices who started under the previous regime. Levy paying employers direct spending for the apprentices they employ. Apprentices in smaller employers are funded where colleges or providers have an ESFA contract. The formula includes funding bands which group apprenticeship standards and frameworks according to assessed cost. In addition, there are top-up payments where apprentices are under 19, live in areas assessed as disadvantaged and for English, maths and learner support. Colleges and providers are paid for each apprentice individually based on data supplied via the Individual Learner Record (ILR) and Digital Apprenticeship Service (for levy paying employers). Payments are made monthly.
- **Adult education budget formula.** ESFA uses a formula to calculate adult education funding. The formula prices each learning aim and includes uplifts to pay for extra support for disadvantaged young people; courses that cost more to deliver and areas of the country where delivery costs are higher. ESFA uses the same disadvantage and area cost data in 16-to-18 and adult formulae but different course-related data. There is an additional achievement factor in the adult formula. ESFA sets adult education budget allocation at the start of the year but adjusts them at various performance points during the year.

14. There are also some big reforms underway:

- **Technical education reforms.** DfE's Skills Plan aims to improve 16 to 18 education by introducing T levels in the early 2020s. 52 colleges and schools will pilot the first three T levels in 2020-21 with more qualifications becoming available in more institutions in the years that follow. The longer term aim is that as many as 20% of the cohort will take T levels. The qualifications will be set at Level 3 and that are being designed to require higher teaching hours, longer industry placements. The government allocated significant extra funds in the spring 2017 budget for the technical education reforms<sup>xxviii</sup>.

TABLE TWO: TECHNICAL EDUCATION FUNDING IN SPRING 2017 BUDGET

16-19 technical education funds	2018-19	2019-20	2020-21	2021-22
Additional spending	60	115	250	445
<i>..of which England (83%)</i>	<i>50</i>	<i>95</i>	<i>208</i>	<i>369</i>

- **Apprenticeship reforms.** Just about everything relating to apprenticeships is changing including the new levy, employer control of funding, a new apprenticeship training register and an overhaul of training content involving new standards, 20% off the job training, end point assessment and development of degree apprenticeships.

TABLE THREE: APPRENTICESHIP LEVY INCOME AND IMPLIED BUDGET

16-19 technical education funds	2016-17	2017-18	2018-19	2019-20
Levy income <sup>xxix</sup>	0	2,300	2,600	2,700
Apprenticeship budget	1,726	1,870	2,047	2,223

- **Adult education budget devolution.** DfE will devolve about £700 million (50% of the adult education budget) in 2019-20 to six Mayoral Combined Authorities (MCAs) and Greater London Authority (GLA). The authorities will also take on legal responsibility for statutory entitlements relating to adults taking basic skills courses, their first Level 2 qualification and first Level 3 qualification when aged under 24.

TABLE FOUR: ADULT EDUCATION BUDGET INDICATIVE DEVOLVED BUDGETS

Adult education budget devolution	Indicative budget based on 2015-16 data
Greater London Authority (GLA)	310
West Midlands Combined Authority (WMCA)	105
Greater Manchester Combined Authority (GMCA)	81
West of England Combined Authority (WECA)	62
Liverpool City Region Combined Authority (LCRCA)	55
Tees Valley Combined Authority (TVCA)	24
Cambridgeshire and Peterborough CA (CPCA)	14
<b>Devolved to the 7 authorities</b>	<b>651</b>
<b>ESFA non-devolved</b>	<b>849</b>

- **College restructuring.** With government encouragement, 58 college mergers and 21 academy conversions have taken place so far in 2016, 2017 and 2018. The Treasury has provided £300 million in loans and grants to support 20 of these mergers. In 2019, DfE will refuse exceptional financial support to colleges that run out of cash.

## Further education funding and costs

15. For several years DfE and ESFA have funded further education with no provision for inflation. Adult education and 16 to 18 funding rates have been fixed since 2009 and 2013 respectively. Apprenticeship standards and rates have changed so much in 2017 that it is difficult to do a like-for-like comparison but funding per apprentices is being kept down to ensure more can be trained. In the recent past, the operation of the funding formulae has allowed one-off increases in funding through an adjustment in factors, a shift in student characteristics or higher rates associated with new qualifications but opportunities to do this are now very limited. Fixed funding rates now force relentless annual efficiency gains.
16. The official target for the Consumer Price Index is that it should rise by 2% a year. CPI has been consistently above 2% since the start of 2017 and is currently 2.8%. The costs for colleges will rise at a higher rate than this between 2015 and 2020. There are several factors in this increase:
  - **Pay rises:** Although national pay settlements have been held to 1% or below, some staff benefit from moving up pay scales. Average FE teacher pay is £7,000 (20%) a year lower than pay in schools<sup>xxx</sup> and there is understandable pressure to offer pay rises to match inflation, NHS and local government settlements. Staff turnover rates in colleges average 17% in 2017 and the hardest-to-fill posts still being teaching jobs in engineering, construction and mathematics
  - **Higher social costs:** Pension and national insurance costs have escalated in recent years. National insurance costs rose from 10.4% to 13.8% in 2016/ Teacher pension contributions which used to be 8% in the early 2000s rose from 14.1% to 16.48% in 2015 and may rise further in 2019. The average local government pension scheme contribution paid by a college exceeds 17%.
  - **Unfunded obligations.** Parliament, DfE and Ofsted have all created new obligations on colleges in recent years without providing any compensating funding. There is no equivalent to the new burdens policy which aims to protect local government budgets. Recent obligations include the English and maths condition of funding; the administration associated with negotiating individual budgets for students with education health and care plans and for apprentices supported via the levy; the

careers advice obligations set out in DfE's careers strategy (the Gatsby benchmarks) and the anti-extremism requirements of the Prevent strategy

- **National minimum wage.** The main rate (for over 25s) increased from £7.50 to £7.83 in April 2018. The increases in recent years have been 7.4% (2016), 4.2% (2017) and 4.4% (2018). OBR forecast a 4.5% increase in April 2019 but the amounts will not be known until the end of 2018.
  - **Exam fees.** These often rise by more than inflation because the main costs are staff costs, because there is limited competition and because awarding bodies face the costs of government inspired curriculum change.
  - **Energy prices.** Oil prices rose by 50% between 2016 and 2018 with some signs they may rise further in the next 12 months.
  - **Subscriptions.** DfE will start charging fees to providers on the Office for Students register from August 2019. The planned schedule of fees was published in DfE's consultation outcome circular in February 2018. Fees will not be confirmed until April 2019 but the range is from £10,000 to £50,000 for colleges with higher education.
17. The Consumer Prices Index assembles a basket of goods and services that an average household buys and calculates the weighted average of the price change each month and year. The services and supplies that college buy are mainly the people they employ so a College Prices Index needs to account for the share of expenditure and changing prices of each share. The table below makes some basic assumptions about recent and future changes in prices for a model college that started 2015 with a staff cost ratio of 63% with 60% of its staff costs being teachers. The model assumes that pay rises in line with the official forecast of average economy-wide earnings<sup>xxxix</sup>, that the TPS employer contribution rises to 19% in September 2019, that there are stepped increases in LGPS contributions and that prices of supplies and services rise in line with actual and forecast CPI.

TABLE FIVE: CALCULATION A COLLEGE PRICES INDEX

College prices index	2015	2016	2017	2018	2019	2020
Pay	52.4	53.5	54.5	55.9	57.6	59.5
TPS Pensions	4.6	4.8	4.9	5.1	5.3	5.5
LGPS Pensions	3.3	3.4	3.5	3.6	3.7	3.8
NI	5.9	6.2	6.4	6.5	6.7	6.9
Total pay	63.0	67.9	69.3	71.0	73.2	75.7
Exams	3.0	3.1	3.2	3.3	3.4	3.5
Supplies/services	22.8	23.0	23.6	24.1	24.7	25.4
Subscriptions	0.0	0.0	0.0	0.0	0.1	0.2
Interest	2.4	2.4	2.4	2.4	2.4	2.4
Depreciation	7.8	8.0	8.1	8.3	8.4	8.6
Total expenditure	99.0	104.3	106.6	109.1	112.3	115.8
Total income	100.0					
Surplus	1.0					
<b>Price increase per year</b>		<b>5.4%</b>	<b>2.2%</b>	<b>2.4%</b>	<b>2.9%</b>	<b>3.1%</b>
College CPI	100.0	105.4	107.7	110.2	113.4	116.9

18. The government decision to make no changes at all to FE funding rates means that the costs of these higher prices – the 16% increase over 5 years – has to be absorbed by internal efficiency gains. This is the reason why colleges have had to make pay awards below levels in other sectors, to increase teacher contact time, to close courses with smaller numbers of students (no matter how valuable to the economy) and to find other savings wherever they can find them.

## Competition and new institutions

19. Over the last fifteen years, government ministers have encouraged new institutions in an effort to intensify competition and encourage innovation. New institutions have secured public funding – and entered the education market – in a number of different places in post-16 education.
- **New school sixth forms.** DfE published a policy to open new sixth forms in 2004 and this has happened via the creation of new institutions and the addition of 16+ provision to 11-16 secondary schools. 169 new academy and maintained sixth forms were opened between 2010 and 2015<sup>xxxii</sup> – an increase of 8% – but the total numbers of students was static. In March

2016, Ministers introduced five new tests to ensure that new sixth forms are viable<sup>xxxiii</sup>. There have been few new sixth forms in the last two years but the number of sixth form pupils is now falling so this means more problems with viability. There is a long tail of small institutions, with 1,180 school sixth forms enrolling fewer than 100 students<sup>xxxiv</sup>. There is emerging evidence that some of their performance is sub-standard<sup>xxxv</sup>. A number of schools and academies run their sixth forms on a collaborative basis via multi academy trusts and there is anecdotal evidence of some closures.

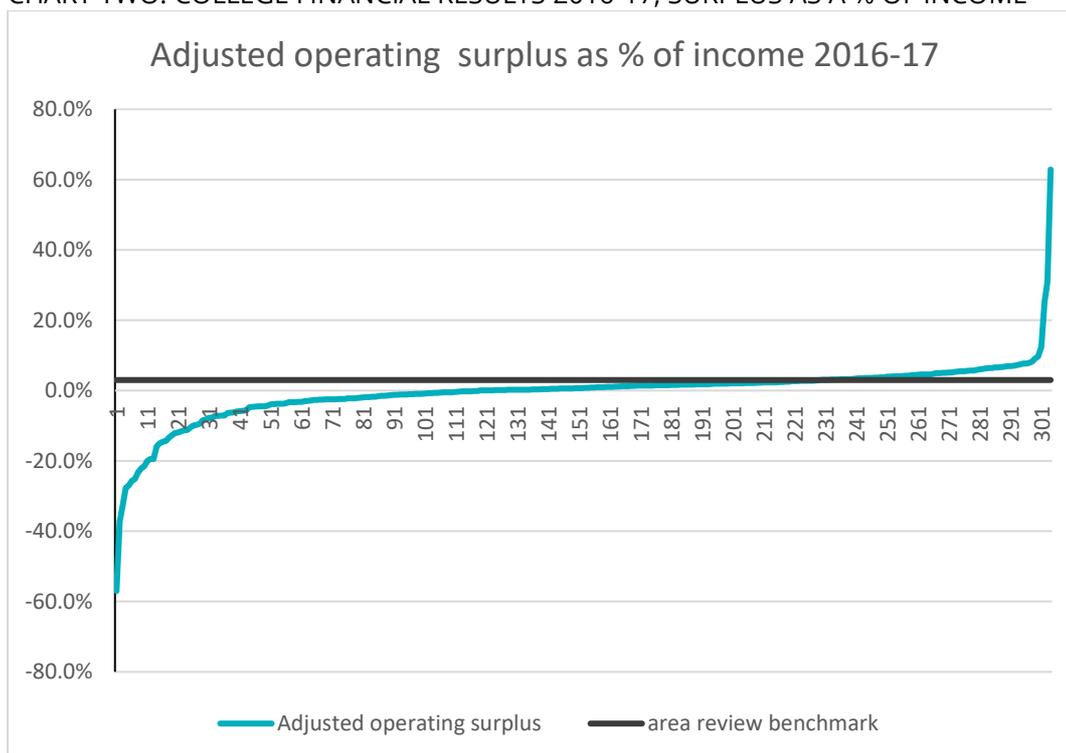
- **University technical colleges and 16-19 free schools.** DfE has supported the opening of UTCs and 16-19 free schools as part of the free school programme started in 2010. University Technical Colleges (UTCs) have struggled to achieve viability in a system currently built around exams and transfer at age 16 and, as a result, six have closed while one did not open as planned<sup>xxxvi</sup>.
  - **New apprenticeship training providers.** The number of publicly-funded independent training providers has grown in the last two decades partly as a result of policy to encourage competition and partly because public procurement has been used to allocate a rising share of FE funds including Train to Gain and apprenticeship funding. The introduction of the levy and employer control of training funds has given a further boost to this phenomenon. There are now 2,622 organisations on the register of apprenticeship training providers.
  - **Alternative higher education providers.** The number of publicly funded higher education providers has grown in recent years with encouragement given by the standardization of regulations under the 2017 Higher Education and Research Act.
20. This growth continued even while financial pressures has increased. The college sector has responded to these pressures in various ways but since 2015 there has been significant consolidation. As a result of mergers, there are 20% fewer college corporations than there were 3 years ago. Multi-academy trusts have developed but there has been no comparable rationalization of school sixth forms. There have been very few mergers among universities, presumably because of pension differences and problems associated with league tables. There has been consolidation among training providers but the open nature of the market means that it is as easy for new providers to win contracts as to buy up existing businesses.
21. There are disadvantages from the proliferation of large number of publicly-funded education and training organisations which may outweigh the advantages in terms of competition and innovation. More places at which to study may have also resulted in less choice of subject. Competition has forced colleges, schools and training providers to drop minority courses which has resulted in a big reduction

in A-level language provision and loss of some specialist courses for employers. There is also duplication which also means more money spent on management, administration and support services. The lowering of entry barriers and the lack of arrangement for market exit may be contributing to lower operating margins and therefore to lower funds available for reinvestment. The various regulators and funding agencies struggle as a result of the span of their control and struggle to prevent misuse of funds. They might find it easier to manage a smaller number of better resourced organisations.

## The financial position of colleges

22. The overall financial position of the college sector has stabilised in the last two years. Colleges are working with government on recovery plans to improve the position of those with inadequate financial health. The £300 million committed so far in grants and (mainly) loans to support college restructuring between 2016 and 2019 will help turn around the financially weakest colleges. However wider issues in income and spending will continue to knock some institutions sideways.
23. This is not an issue of weak leadership. The English college sector has faced and overcome financial challenges in the past. For example, in 1998 when 96 colleges (22%) were judged to be financially weak<sup>xxxvii</sup> or in 2009 when 80 colleges were forced to abandon capital projects<sup>xxxviii</sup>. The position this time is serious because there are no easy options.
24. On an unadjusted basis, English colleges reported a £144 million deficit. In the same period and using the same accounting standard, English universities reported a combined surplus of £1 billion.
25. The Education and Skills Funding Agency (ESFA) uses the adjusted operating surplus figures to assess college performance. The adjustments exclude non-cash local government pension transactions, ESFA's exceptional financial support and taxation. Colleges have no control over the pension transactions while the other items are exceptional and may distort understanding of the college performance.
26. With these adjustments, colleges reported a total surplus of just £3 million for 2016-17, just 0.3% of income. A small number of colleges reported large deficits. This offset the larger number of colleges reporting small surpluses. Only 23% of colleges achieved the area review benchmark that they should achieve surpluses at 3% of income.

CHART TWO: COLLEGE FINANCIAL RESULTS 2016-17, SURPLUS AS A % OF INCOME



27. The National Audit Office reviewed college finances in 2015 and reported that the financial position of FE colleges was declining. The table below updates NAO's figures for the most recent two years.

TABLE SIX: FE COLLEGE RESULTS 2011-17, WHOLE COLLEGE GROUP SURPLUS/DEFICIT

FE Colleges	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17
Whole FE college surplus/deficit (£m)	142	13	(34)	(33)	(44)	3
Number of colleges	250	245	244	233	228	205
Number of colleges in deficit	62	89	110	81	81	82
<i>(with more than 5% of income)</i>	12	33	47	33	42	32
Percentage of colleges in deficit	25%	36%	45%	34%	35%	40%
<i>(with more than 5% of income)</i>	5%	13%	19%	15%	18%	16%

28. There are some signs of improvement for the FE college group as a whole but the number of colleges in deficit is as high as ever. This is partly a reflection of the time it takes to turn the financial position around. The year 2016-17 was the first in which the government's decisions to stabilise funding took effect but college decisions to bring their budgets into balance involve short-term costs and therefore deficits.

29. NAO's report just looked at FE colleges. The table below provides comparable figures for sixth form colleges which are stronger overall but still worrying. While many sixth form colleges have protected their financial position by growing their enrolments and making savings, a minority are vulnerable and have fewer options than other colleges or schools to turn themselves around because of their dependence on 16 to 18 income.

TABLE SEVEN: SIXTH FORM COLLEGE RESULTS 2011-17, WHOLE COLLEGE GROUP SURPLUS

Sixth form colleges	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17
Whole SFC surplus (£m)	36	20	12	10	11	9
Number of colleges	91	91	90	90	90	83
Number of colleges in deficit	10	16	23	29	26	19
<i>(with more than 5% of income)</i>	<i>4</i>	<i>6</i>	<i>8</i>	<i>10</i>	<i>9</i>	<i>11</i>
Percentage of colleges in deficit	11%	18%	25%	32%	28%	22%
<i>(with more than 5% of income)</i>	<i>4%</i>	<i>7%</i>	<i>9%</i>	<i>11%</i>	<i>10%</i>	<i>13%</i>

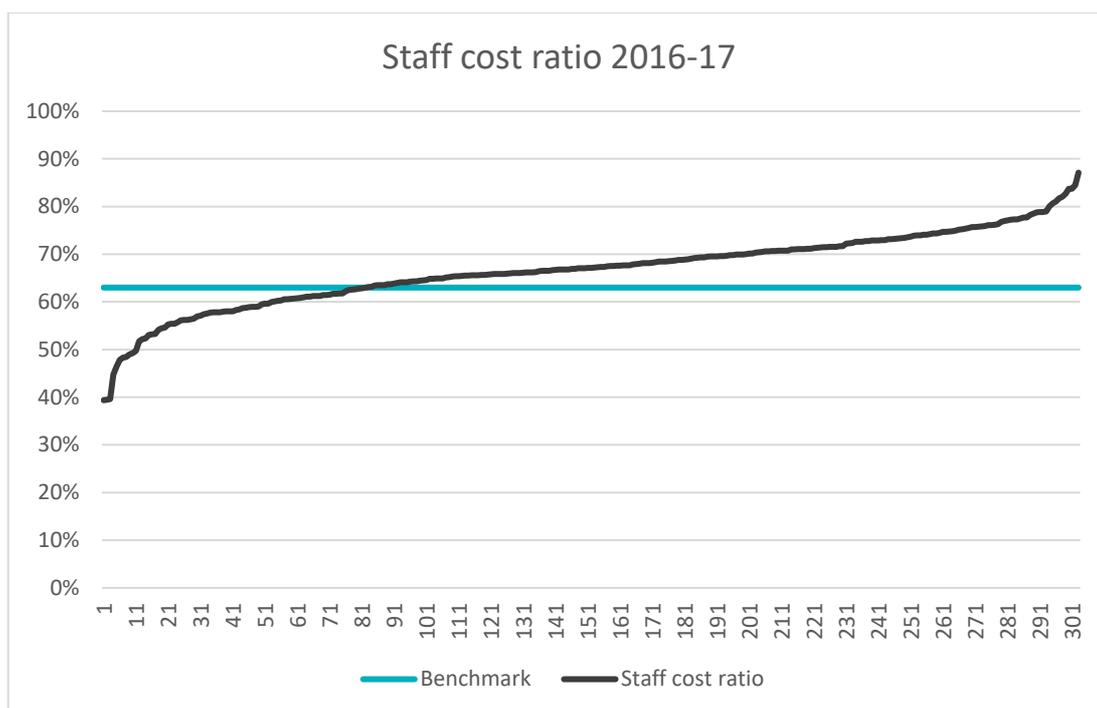
## Pay and staff costs in colleges

30. Colleges employ expert and qualified staff to teach, train and support students. They spend the majority of their budgets on people, of which teaching costs are the biggest share. In 2016-17, teaching staff costs represented 37% of total college income while other staff costs accounted for 28%. There are considerable variations in teaching staff costs which reflect differing practices in different colleges. Work carried out by Mckinsey for HM Treasury in 2015<sup>xxxix</sup> confirmed that the main drivers of teaching costs were:

- Staffing mix
- Teacher salaries
- Teaching contact hours
- Class or group size
- Teaching hours per learner

31. Colleges manage these ratios carefully but face an upward pressure on staff costs because of the competition to retain, recruit and motivate staff. This means that the majority of colleges exceeded the area review benchmark that staff costs should not normally be more than 63% of income. Staff costs averaged 65% of income in FE colleges and 71% of income in sixth form colleges.

CHART THREE: COLLEGE FINANCIAL RESULTS 2016-17, STAFF COSTS AS A % OF INCOME



32. Colleges spent £61 million on restructuring costs in 2016-17 – almost 1% of income. £52 million of these costs were contractual. Spending on restructuring exceeded £100 million in 2014-15 which was a contributory factor in that year to the poor financial results.
33. Like all organisations, colleges report spending on key management personnel (Senior Management Teams). Total spending on SMT salaries in 2016-17 was £130 million with spending on principals/CEOs adding up to a total of £39 million. The higher number of mergers than usual in 2016-17 resulted in more redundancies of one or more principals and higher pay as a result. Mean principal/CEO pay was £130,000. The ratio between the top and the median salary is less than 5:1 in most colleges.

## College income sources

34. Overall college income has fallen from £7.8 billion in 2009-10 to less than £7 billion in 2017-18 mainly because of public spending cuts<sup>x1</sup>. The experience of funding reductions in recent years has been a cumulative series of small reductions. It can be difficult to see trends on a year-by-year basis so the table below shows the changes over three-year intervals, using and extending the analysis from the NAO report.

TABLE EIGHT: FE COLLEGE INCOME SOURCES AT THREE YEAR INTERVALS 2010 TO 2016

	2010-11 £ millions	2013-14 £ millions	2016-17 £ millions
16-to-19 year olds	3,273	3,151	2,880
Adult FE	1,840	1,508	1,261
HEFCE, councils and other grants	589	431	410
Public grant funding	5,702	5,090	4,551

35. NAO's 2015 report only looked at FE colleges. Here is the position for sixth form colleges.

TABLE NINE: SIXTH FORM COLLEGE INCOME AT THREE YEAR INTERVALS 2010 TO 2016

	2010-11 £ millions	2013-14 £ millions	2016-17 £ millions
16-to-19 year olds	733	708	655
Other grants	156	137	190
Public grant funding	889	845	855

36. Grants to FE colleges have reduced by more than £1 billion in six years with reductions ranging from a 12% cash reduction in six years in 16 to 18 education to a 32% reduction in adult FE. The position for sixth form colleges at a college group level is healthier but the decisions by government to limit education spending and prioritise funding on schools has had clear consequences in terms of reduced income.
37. Tracking college income is difficult because there are several different income sources and funding systems. The chart illustrates the figures for the 2016-17 financial year

TABLE TEN: COLLEGE INCOME SOURCES, 2016-17

College income, £ million, 2016-17	FE college	Sixth form colleges	All college corporations
ESFA grant for 16-18	2,433	665	3,098
Adult education budget	790	11	801
Apprenticeships	590	7	597
Higher education (loans & grants)	503	6	509
Catering, Income generation and other	454	43	497
Learner support, ESF and other grants	284	49	333
Fees	339	10	349
Release of capital grants	99	42	141
Advanced learner loans	136	2	138
High needs	229	19	248
Restructuring and transition grants	20	-	20
ESFA 14-16 grants	15	-	15
Endowment and investment income	8	1	9
	5,900	855	6,755

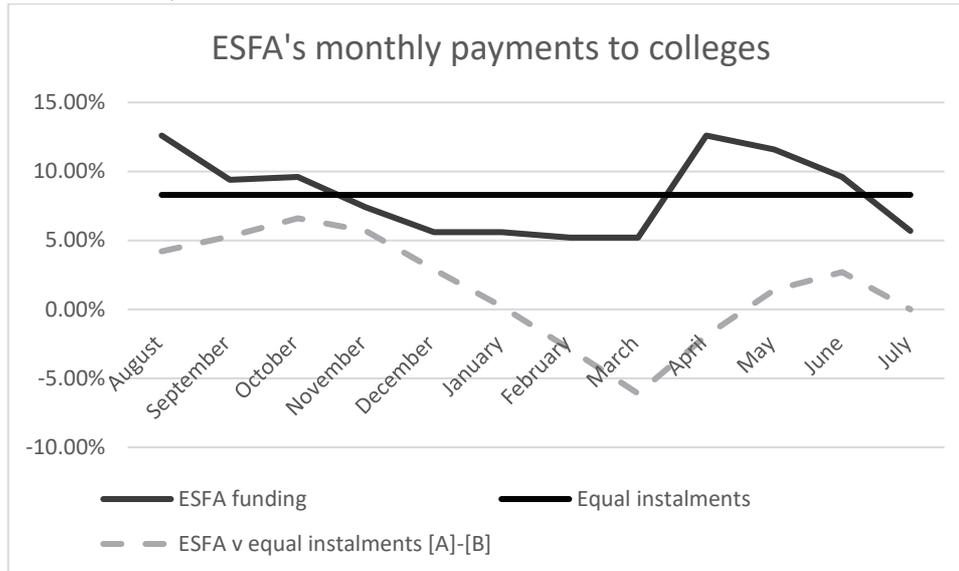
TABLE ELEVEN: COLLEGE INCOME SOURCES IN PERCENTAGES, 2016-17

College income shares, 2016-17	FE college099	Sixth form colleges	All college corporations
ESFA grant for 16-18	41%	78%	46%
Adult education budget	13%	1%	12%
Apprenticeships	10%	1%	9%
Higher education (loans & grants)	9%	1%	8%
Catering, Income generation and other	8%	5%	7%
Learner support, ESF and other grants	5%	6%	5%
Fees	6%	1%	5%
Release of capital grants	2%	5%	2%
Advanced learner loans	2%	-	2%
High needs	4%	2%	4%
Restructuring and transition grants	-	-	-
ESFA 14-16 grants	-	-	-
Endowment and investment income	-	-	-
	100%	100%	100%

## College assets, cash and borrowings

38. English colleges have substantial assets but they are unevenly distributed. The total value of land and buildings is £11 billion but with £1.2 billion in borrowings, more than £3 billion in Local Government Pension scheme and £3 billion in deferred capital grants, net assets/ total reserves are £3 billion. 50 colleges reported net liabilities/negative reserves but this is because they value their land at existing education use and because of their share of LGPS deficits which have been inflated by low interest rates. The colleges with the largest net asset figure (£258 million) is a recently merged London college that revalued its land in advance of the transaction. Compared to universities, colleges have relatively small landholdings and small reserves.
39. Colleges held cash balances of just over £1 billion at 31 July 2017, which represented an average of 75 cash days, However 70 colleges held less than 30 cash days at that point which meant they have to manage payments and receipts very tightly, For reasons that no-one in ESFA ever justifies, the funding agency pays colleges different amounts of money each month with a shortfall of 6% each March. The chart below summarises the position. The most common month where colleges run short of cash is March. ESFA's predecessors used to bring forward grant payments to support colleges in these cases. Officials decided in 2014 that these advances represented government loans, The application process exceptional financial support has become more and more difficult each year. From next year, advances will no longer be made and there is a threat that ESFA will call in an insolvency practitioner where a college runs out of cash.

CHART FOUR; ESFA's MONTHLY PAYMENT PROFILE



40. Colleges have borrowed money from banks since the 1990s and, since 2012, have been able to do so without prior approval from government. The college sector was a net borrower between 2010 and 2015 which was a time when government paid more than £350 million to support building projects. At the start of area reviews in 2015, two banks (Barclays and Lloyds) accounted for a total of 90% of long-term loans to colleges between them. Barclays continue to make new loans to colleges they assess as having sound finances and strong management teams while Lloyds have generally sought to reduce their exposure. Santander have made some new loans
  
41. The government's Restructuring Facility process has involved complicated three-way negotiations between the ESFA's Transaction Unit, the college and the bank. The process has typically taken 9 months and involves sign-off at five different levels within government. ESFA's Transaction Unit agrees a customised loan for each college based on an assessment of affordability. Colleges have been required to employ accountants to double check their data. The ESFA loan generally sits alongside a bank loan. All banks new require security against loans to colleges and an intercreditor agreement to determine their rights vis-à-vis government. This requires advice from valuers and lawyers. Fees typically run to several hundred thousand pounds which is a cost added to the amount covered by the government loan.
  
42. Total college borrowing has fallen from £1.5 billion in July 2015 to £1.25 billion in July 2017 and is likely to fall further as a result of repayments. A share of these loans in future will be restructuring advances owed by colleges to the government. The ESFA's Transaction unit insists that colleges keep the terms of individual loans confidential until 2019. As at 31 March 2018, ESFA's financial statements record a total for loans (£124 million). Officials reported in summer 2018 that a total of £300 million had been paid out of committed. These loans last for no more than

ten years, involve an interest rate and are adjusted to forecast college cashflows. The provision of restructuring loans has helped some colleges improve their finances but does not address all the issues covered elsewhere in this paper.

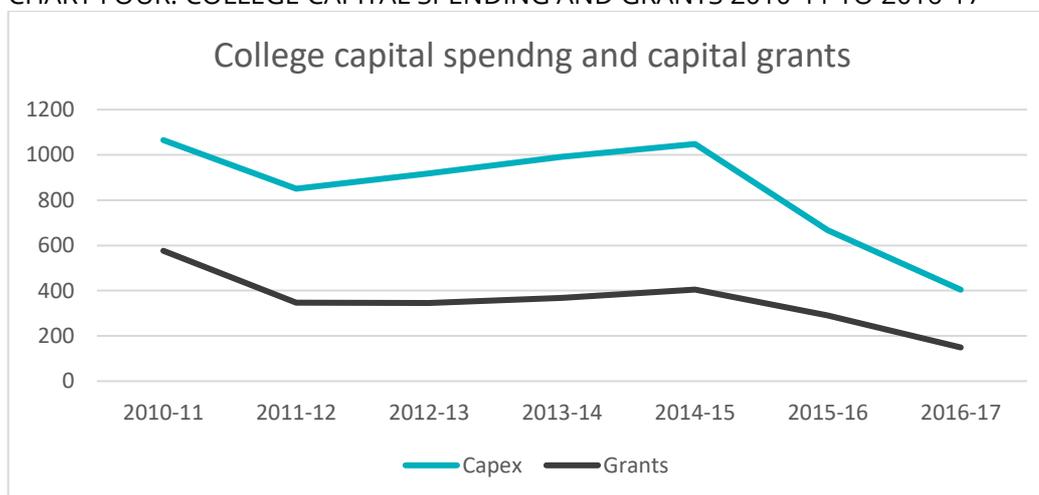
TABLE TWELVE: ESFA LOANS TO COLLEGES

ESFA loans to colleges	31 March 2018	31 March 2017
Expire within one year	28	25
Lasting more than one year	96	25
	124	50

## Capital expenditure

43. One of the successes of college self-government in the 1990s and 2000s has been the modernisation of buildings which were severely neglected in the previous decades. The college capital model involves colleges managing a project and funding it with a combination of government grants, borrowing, land sales and their own resources. The era of lots of very large capital grants to colleges stopped in 2009 when the Learning and Skills Council had to cancel its college rebuilding programme for lack of money. However some big schemes did continue and the college sector spent a total of £4.9 billion in capital expenditure between 2010 and 2015 – an average of almost a billion a year. Capital spending has reduced since then and was just £404 million in 2016-17.

CHART FOUR: COLLEGE CAPITAL SPENDING AND GRANTS 2010-11 TO 2016-17



44. Government increased capital grants to colleges in 2013/14 and 2014/15 following the publication of research which identified positive returns from this spending. In 2012 – at a time of sluggish economic growth - the Treasury was interested in positive spin-offs from public investment. In some cases, individual colleges spent too much and ran into financial difficulties which were advertised in FE commissioner reports. Changes in capital funding came in 2015. The 38 Local Enterprise Partnerships took responsibility for the skills capital budget and have

taken a more directive approach to spending. Some LEPs have funded significant college rebuilds but others have spent the money on something else entirely. DfE's total FE capital budget of £200 million is likely to be substantially underspent in 2018-19 and there is the risk of under-investment given the needs and demands of the 2020s.

TABLE THIRTEEN: COLLEGE CAPITAL SPENDING AND FINANCING, SELECTED YEARS

	2012-13	2014-15	2016-17
Total capital spending	(918)	(1,048)	(404)
Loan repayments	(255)	(112)	(233)
New loans	289	183	149
Receipts from land sales	137	117	142
Capital grants	346	405	149
Net cash contribution	401	455	197

## Assessing College financial health

45. One of the objectives of the government's area review programme in 2015 was to put all colleges on a sustainable financial footing. The review programme has prompted 47 college-to-college mergers since January 2016 with 10 more scheduled for the rest of 2018. Mergers and sixth form college conversions have reduced the total number of colleges from 340 in 2015 to 269 now, of whom 207 are FE corporations.
46. ESFA's latest assessment of college financial health in summer 2018 judged 167 colleges to have good or outstanding financial health, 73 satisfactory and 23 to be financially inadequate. Mergers have reduced the number of colleges judged inadequate but it is too early to judge the full impact of the post-2016 mergers. Improvements in financial health ratings have come mainly through staff cost reductions and debt repayment. There are not many colleges reporting substantial like-by-like increases in income (ie unrelated to mergers).

TABLE FOURTEEN: COLLEGE FINANCIAL HEALTH RATINGS

Colleges	2013-14	2014-15	2015-16	2016-17	2017-18
Good/outstanding	202 (61%)	214 (65%)	196 (60%)	182 (60%)	167 (63%)
Satisfactory	100 (29%)	82 (24%)	94 (28%)	83 (27%)	73 (27%)
Inadequate	32 (10%)	37 (11%)	38 (12%)	39 (13%)	24 (9%)
	334	333	328	304	264

47. Concerns about financial weakness in colleges reached a peak in the second half of 2015. The National Audit Office reported a prediction that there would be 100 financially inadequate colleges by the end of 2016 and the FE commissioner used this to encourage colleges to participate seriously in area review discussions. In the months leading up to the 2015 spending review, there was talk of large revenue spending cuts to come (10% cuts to the 16-to-18 budget and 40% to

adult education). These concerns were firmly based because officials did model cuts but the spending review outcome was less worse than feared and a number of colleges have used the last few years to reset their finances and their plans, including, in some cases, merger. The financial health rating show a steadying picture and concerns about college finances have subsided. However it is right to be cautious

- **A single rating is not always reliable.** Several of those closely supervising colleges says that ESFA ratings provide a flattering picture of health. Colleges are downgraded if they have large long-term debts (ie over 40% of income). The fact that many colleges have or are repaying their debts contributes to an improving picture.
- **Pressure on operating margins.** The colleges sector reported a minimal operating surplus in 2016-17 but face pressure on every income line in 2018, either in the form of competition or below-inflation rate changes.
- **Difficulties associated with predictions:** Financial health grades are partly based on forecasts which are sometimes difficult to make because of human error and unpredictable funding. Colleges prepared their latest set of forecasts in July 2019. Within six weeks decisions on apprenticeship procurement and teacher pensions could have upset carefully made plans. Colleges veer between too much pessimism and over optimism but getting things completely right is near-impossible.
- **A tougher financial oversight regime.** DFE plans to introduce the college insolvency regime in early 2019 at which point it will also withdraw exceptional financial support. Colleges who cannot meet their monthly payroll or invoice run will have DFE-appointed insolvency appointed to run their affairs and review their future.

## Intervention

48. Ever since colleges became self-governing in the early 1990s, there has been a need for the responsible government agency to intervene where things have gone wrong. The Learning and Skills Council had responsibility for oversight of colleges between 2001 and 2010 and had considerable powers and money to secure change but colleges remained self-governing. In their first years of office, coalition government ministers sought to increase this autonomy by allowing colleges freedoms and flexibilities in making their own decisions. The mood shifted in 2012 when Ofsted judged a number of colleges to be inadequate under a new inspection framework<sup>xli</sup>. In response to concerns that colleges were not acting fast enough, the then minister created the FE commissioner role to act as a single point of contact as an agent of the Secretary of State<sup>xlii</sup>. The first FE Commissioner started in November 2013 and the role has evolved over more than three years but retains some standard features. Every intervention involves a formal

assessment of the college's position which is reported publicly and recommendations to the Minister for Apprenticeships and Skills. The Minister then writes to the chair of governors of the college setting out the outcome of the intervention and confirming the next steps<sup>xliii</sup>. The process respects the self-governing status of colleges but government continues to deploy incentives and penalties to secure change.

49. The current intervention system was developed to deal mainly with quality issues but, by the start of 2014, financial problems were a bigger issue. Several years of public spending cuts combined with recruitment shortfalls and a slow response in cutting costs led more and more colleges to report deficits. A negative cycle developed from 2013 onwards in which some colleges breached the terms of their bank loans, prompting the bank to require action and, in some cases, to withdraw credit. This, in turn, prompted rising spending on exceptional financial support which was documented and criticized by National Audit Office in 2015<sup>xliv</sup>. The funding agencies have always given exceptional financial support to one or two colleges in trouble on a short-term basis but the issue attracted more attention in 2014 when government accountants decided that the support constituted fully fledged loans and should be governed by formal agreements.
50. Whether the problem was about quality, finance or both, the first FE commissioner, David Collins, generally criticized the leadership of the colleges he visited in the 18 months between his appointment and the 2015 general election<sup>xlv</sup>. His reports generally prompted leadership change but also structural remedies. In some cases the commissioner recommended that the minister should put the college into "administered status" so that he could carry out a "structure and prospects appraisal" to consider its future. Administered status is not a legal category but reduced the college's freedom to take independent decisions. For several years a series of ministers had discouraged college mergers but, in April 2015, for the first time, a commissioner-led appraisal led directly to college merger. Building on the experience that the turnaround in one college often depends on its position in relation to its neighbours, the FE commissioner carried out two pilot area reviews in the first half of 2015 in which he examined issues in two groups of colleges<sup>xlvi</sup>. This was the genesis of the area review plan launched by the Skills Minister in the weeks following the 2015 general election<sup>xlvii</sup>.
51. Between September 2015 and March 2017, government intervention in colleges was supplemented by a national programme of post-16 area reviews. Area reviews were a national stocktake of colleges involving 37 geographically based reviews of 332 colleges<sup>xlviii</sup>. Area reviews followed a standard process and resulted in a large number of recommendations that colleges merge. For various reasons, many mergers did not happen as planned but over two-and-a-half years, there have been 50 college-to-college mergers which is the biggest restructuring of the sector since the 1980s. The reviews also helped persuade government to remove the obstacles to sixth form colleges converting to become academies. 20 sixth form colleges have followed this route and are now 16-to-19 academies. Area

reviews were intended to create a financially sustainable college network by 2018 but this has not happened for various reasons. Colleges operate in a haphazard environment where funding changes unexpectedly and where events like Ofsted inspections can derail plans. College income is uncertain because enrolments in competitive markets for students and apprentices can fall quite quickly. The scope of area reviews was too limited. Area reviews covered every college in the country but ignored school sixth forms, UTCs or training providers. In a couple of cases the area review was seeking to rationalise 16-to-18 education in colleges while another arm of DFE was supporting the opening of new school sixth form provision. Government set out the aim at the start of the exercise to secure more mergers but did not tackle some of the obstacles that make these more difficult.

52. FE commissioner interventions in individual colleges continued while area review took place and after they finished. The FE commissioner acts where Ofsted judge a college to be inadequate (now fewer than 4% of colleges) or where the finances are weak. A negative Ofsted rating harms income because it tends to reduce enrolment and also cuts colleges off from some funding sources<sup>xlix</sup>. The FE commissioner – Richard Atkins since the start of 2017 – has initiated a number of structure and prospects appraisals in colleges to review their long-term viability. There has been pressure in 2018 to take action before the Restructuring facility runs out. This will prompt another round of mergers in early 2019. Meanwhile DfE is also moving ahead with its plans to extend insolvency rules to colleges.

## The college insolvency regime

53. The government has introduced a further twist to the college intervention regime in 2017 via a customized statutory insolvency regime. There are currently no clear rules about what happens if a college ran out of money and the government did not stand behind it. When the Conservative Government transferred colleges out of local government in 1992, it created a new type of statutory corporation to run colleges but it did not make any rules for cases where they ran out of money. Instead central government (via a succession of funding agencies) has ended up being the funder of last resort - to protect the college's students, courses and assets. This has meant that the banks have always been paid in full or been able to replace an old loan with a new one.
54. The 2017 Technical and Further Education Act will put this into effect and is intended to provide clarity about what happens when a college gets into severe financial problems. The law creates a special administration regime for colleges akin to that put in place in recent years for energy companies, train operating companies and housing associations. The special administrator will have duties to protect learners as well as creditors. The aim is to protect a public service while creating an orderly process to deal with a situation where the organisation providing that service has run out of money.

55. The new college insolvency regime will supplement the existing intervention regime run by EFSA and the FE commissioner. Officials describe the college insolvency regime as a "last resort" rather than a "normal route" to secure change. Once the new arrangements come into force, there will be several lines of control in place:
- Governing bodies, who have a duty to ensure the solvency and viability of colleges
  - ESFA, which has financial oversight
  - FE commissioner, who intervenes where the college has a notice to improve
  - Independent Business Review, a new process for colleges in severe financial distress
  - If all the above fail to resolve matters, the college insolvency regime will apply.
56. The majority of colleges will be unaffected by the existence of a special administrator just as the majority of companies and charities never see a normal insolvency practitioner.

## What next?

57. There are some positive trends which offset these concerns:
- **Technical education:** Colleges will benefit from the priority placed on technical education by DfE and money allocated in the 2017 Budget.
  - **Strong financial management in colleges.** Colleges are well managed financially. For the average college earnings 99before depreciation, tax and interest (EBITDA) are above 5% of income and expected to rise in 2017-18. Collectively the college sector is repaying debts built up at the start of the decade. Despite falling income, the FE college debt-to-income ratio is expected to fall to 23% by July 2018<sup>i</sup>.
  - **The Post 18 review.** The Prime Minister's statement on the government's Post 18 education and funding review is a clear sign of government intent to rebalance the higher education system towards the types of courses where colleges have historic strengths<sup>ii</sup>.
  - **The role of skills in the industrial strategy.** The government's industrial strategy includes a strong emphasis on skills. More generally, there is a wider awareness of the positive economic case for greater spending on education and training both for individuals and employers<sup>iii</sup>. Exit from the EU makes this issue even more critical because skills are identified by many businesses as their major concern. If there are reductions in immigration, employer behaviour will need to change. In some sectors, the non-UK EU workforce is in excess of 15% of the total<sup>iiii</sup>. Government action

is needed to ensure that the young population is properly prepared for the future but also to help train adults to fill future vacancies.

58. There is now widespread understanding that colleges are underfunded. In recent months, three thinktanks, two commissioners and the chief inspector have all commented or reported on underfunding. There is widespread agreement between ministers, officials, college leaders, representative organisations like AoC, trade unions and the NUS all agree on this. The point in the next 12 months will be to turn this understanding into action. AoC will be making a submission to HM Treasury in advance of the Autumn budget and will be working with others to address some of the issues in this report. If you have any queries on this work or comments on the report, please contact [Julian\\_Gravatt@aoc.co.uk](mailto:Julian_Gravatt@aoc.co.uk)

Association of Colleges  
14 September 2018

## Endnotes

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- <sup>i</sup> Following the latest mergers on 1 August 2018, there are 266 college corporations of whom 61 are sixth form colleges
- <sup>ii</sup> Calculations from consolidated college accounts for 2016-17. There is more information on college income sources later in this report.
- <sup>iii</sup> DfE latest 16-18 participation statistics report a fall in 50,000 (4%) in the number of 16 to 18 year olds in full-time education from 1,375,000 in autumn 2015 to 1,325,000 in autumn 2017, Table 3
- <sup>iv</sup> FE college enrolments of 16-to-18-year-olds in autumn 2017 fell by 15,000 (2.9%) to 515,000 (an average of 2,488 per college). This results in a 2.3% fall in 16 to 18 funding in 2018-19. Funding per 16 to 18 student changes each year based on the funding formula. Sixth form college enrolments of 16-to-18-year-olds fell by 600 (0.6%) to 122,000 (an average of 1,450 per college).
- <sup>v</sup> AoC's Apprenticeship and College Finance Survey, January 2018 suggests a 9% fall in the number of apprenticeships in training in colleges in 2017-18. Apprentices take more than 12 months to complete programmes so the fall in starts this year feeds through to a fall in income next year
- <sup>vi</sup> AoC estimates based on Apprenticeship and College Finance Survey, January 2018
- <sup>vii</sup> CPI has risen by 7.1% between 2013 Q1 and 2018 Q1 and is expected by Bank of England to rise by more than 2% in 2019 and 2020
- <sup>viii</sup> The Technical and Further Education Act 2017 extends commercial insolvency laws to colleges and allows the Education Secretary to appoint a special administrator to take over an insolvent college
- <sup>ix</sup> The spreadsheet is available on the AoC Accounting and Financial Planning pages.
- <sup>x</sup> HEFCE "Financial health of the higher education sector" March 2018
- <sup>xi</sup> Auditor General for Scotland "Scotland's Colleges 2018" June 2018
- <sup>xii</sup> AoC's merger website lists all college mergers and conversions that have been completed or that are underway
- <sup>xiii</sup> Office of Budget Responsibility, Long-term fiscal sustainability report, January 2017
- <sup>xiv</sup> Private spending (on university tuition, private schools and international students) leads OECD to report a high percentage of education spending in the UK - 6.6% of GDP compared to an OECD average of 5.2%. This comparison should be treated with caution. The data relates to 2014 and UK has a younger population than many of its competitors.
- <sup>xv</sup> DfE's pupil number projections forecast that the number of secondary pupils aged 11 to 15 will rise from 2.7 million in 2017 to 3.3 million in 2025. DfE do not forecast 16 to 18 numbers but these figures imply increases throughout the 2020s
- <sup>xvi</sup> Figures from DfE's 2018-19 main estimate memorandum to the Education Select Committee, April 2018
- <sup>xvii</sup> DfE School Costs Technical Note, March 2018
- <sup>xviii</sup> DfE estimates memorandum 2018-19. The college total comprises £120 million for local skills capital and £80 million for Institutes of Technology
- <sup>xix</sup> DfE student loan forecasts 2017-18, June 2018
- <sup>xx</sup> Office of Budget Responsibility, Student loans and fiscal illusions, July 2018
- <sup>xxi</sup> Interpretation of chart 5.1. for OBR, July 2018
- <sup>xxii</sup> DfE estimates memorandum 2018-19 provided to the Education Select Committee
- <sup>xxiii</sup> DfE and ESFA financial statements available on gov.uk website
- <sup>xxiv</sup> IFS Long-term trends in education spending, 2017
- <sup>xxv</sup> House of Commons Library, Adult further education in England since 2010, Briefing 7708, Table 3, combining figures for adult skills excluding apprenticeships and community learning
- <sup>xxvi</sup> AoC estimates from DfE statistical releases and ONS population data for England

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- xxvii The figure on the total costs of the uplifts is in DfE's written evidence to Education Select Committee on School and College Funding, , May 2018
- xxviii HM Treasury, Spring 2017 budget, Page 29. The 83% figure for England assumes a consistent allocation of UK funds to the four nations
- xxix Income figures for 2017-18 from HMRC tax income statistics summarised in 10 September 2018 answer to Parliamentary question (170266). Income figures for 2018-19 and beyond from OBR economic and fiscal outlook
- xxx Median school teacher pay is £37,000 according to the DfE statistics whereas data from the Education and Training Foundation calculates median college lecturer pay at £30,000
- xxxi Bank of England Average Weekly Earnings figures quoted in OBR Economic and Fiscal Outlook, March 2018 page 80
- xxxii DfE answer to written question 220526 sixth form education 16 January 2015.
- xxxiii DfE guidance "Making changes to an existing academy" says that schools wishing to open a new sixth forms have a good or outstanding Ofsted grade; that it should be realistic for the new sixth form to offer 15 subjects and enrol more than 200 students in normal operation; that there should no detrimental financial impact on the rest of the school and that there should not be a negative impact on high quality schools and college nearby.
- xxxiv Statistics on numbers of schools with sixth forms of fewer than 100 pupils supplied by DfE.
- xxxv According to DfE data, the percentage of schools adding more value than expected consistently decreases with the size of institution, below 400 students. Small sixth forms clearly work successfully in private schools but on funding levels more than 200% greater than in the state funded system. Research by the Association of School and College Leaders (ASCL) suggests that 250 students is the minimum efficient number to offer high quality education at current funding levels.
- xxxvi House of Commons Library briefing on UTCs, September 2016
- xxxvii Public Accounts Committee "Management of Growth in the Further Education Sector" 1998
- xxxviii DIUS Select Committee "Spend Spend Spend" 1999
- xxxix BiS, DfE and HMT Joint review of further education cost drivers, 2015
- xl FE colleges started the decade with 81% of their income coming from public sources. Sixth form colleges obtained 94% from public sources. The biggest single income source for almost all colleges are 16 to 18 year olds who are wholly funded by DfE
- xli Ofsted typically revises its inspection framework every 4 years. 16% of FE colleges inspected in 2011-12 were judged inadequate compared to 5% in 2010-11
- xlii BIS and DfE Rigour and Responsiveness in Skills, April 2013
- xliii Description of FE commissioner process taken from DfE website, July 2017
- xliv NAO "Overseeing financial sustainability in the further education sector". This report notes that exceptional financial support advances to colleges were £36 million in September 2012 and £68 million two years later in September 2014
- xlv There were 28 FE commissioner interventions between November 2013 and July 2015, covering 12% of colleges
- xlvi Nottingham (2 colleges) and North East Norfolk/North Suffolk (5 colleges)
- xlvii BIS/DfE "Reviewing post-16 education and training institutions" July 2015
- xlviii Information from FE commissioner reports. Final area review reports (from Waves 4 and 5) have not yet been published
- xlix Colleges judged by Ofsted to require improvement are prevented by the Home Office from recruiting international students on Tier 4 visas while an inadequate judgement removes the college from the register of apprenticeship training providers
- <sup>l</sup> Figures shared by ESFA staff but not yet published
- <sup>li</sup> Prime Minister's speech at Derby College, February 2018
- <sup>lii</sup> "Estimation of the labour market returns to qualifications gained in English Further Education, December 2014" Department for Business, Innovation and Skills (BIS), Research Paper 195).

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<sup>lii</sup> Keohane, Broughton and Ketola “Working together: European Workers in the UK”, SMF, June 2016.