Spring 2018 statement on college finances

Association of Colleges

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Introduction

1. The financial outlook for colleges has deteriorated in the last six months despite the funds made available for education in the Autumn statement and despite the growing understanding that skills matter for our country's future success.

2. The key issues which contribute to our concerns about the position of colleges in 2018-19 are:

   - DfE funding for 16 to 18 education in colleges will fall by around 2% because the autumn census reported a 2% fall in student numbers[1]. Colleges face increased competition for sixth form age students at a time when there are fewer young people. This means colleges are contracting now but will need to expand again when the current school population reaches the age of 16[2].

   - Apprenticeship numbers remain below last year's levels[3] with the result that college income from apprenticeships in 2018-19 forecast to be 2% below income in 2016-17[4] despite the introduction of the levy.

   - Inflation is running above 2% but funding rates remain fixed in cash terms. Retention of teaching staff is a challenge which is why both AoC and SFCA recommended pay rises for 2017-18.

   - Colleges have little control of pension costs. DfE increased Teacher Pension Scheme contributions from 14.1% to 16.48% in 2015 and may make further increases to take effect from April 2019[5].

   - Although some financially weak colleges have merged with stronger counterparts, there are still 35 colleges with financial notices to improve. The planned implementation of the college insolvency regime continues to unsettle banks and governors.

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[1] AoC estimate based on data returned by colleges in November 2017

[2] DfE's pupil number projections forecast that the number of secondary pupils aged 11 to 15 ill 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

[3] AoC's Apprenticeship and College Finance Survey, January 2018 suggests a 9% fall in the number of apprenticeships in training in colleges with 50% of income in 2017-18 accounted for by those who started before the levy started.

[4] AoC estimates based on Apprenticeship and College Finance Survey, January 2018

[5] The valuation of TPS is currently underway but the outcome is uncertain

3. There are some positive trends which offset these concerns:

- Colleges will benefit from £57 million in new DfE funding for work placements in 2018-19, which is the first allocation of funds from the technical education budget allocated in the 2018 Spring Budget

- Colleges are well managed financially. For the average college earnings before 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[6].

- 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[7]

The financial position of colleges

4. Colleges are transformational. They help people make the most of their talents and ambitions and drive social mobility; they help businesses improve productivity and drive economic growth; they are rooted in and committed to their communities and drive tolerance and well-being. They are an essential part of England's education system teaching and training 700,000 young people aged 16 to 18, 300,000 apprentices, 1 million adult learners including 150,000 taking higher education courses. The financial position of colleges is nevertheless a continuing concern. Colleges face five big challenges:

- Income reductions at a time when core costs are rising.

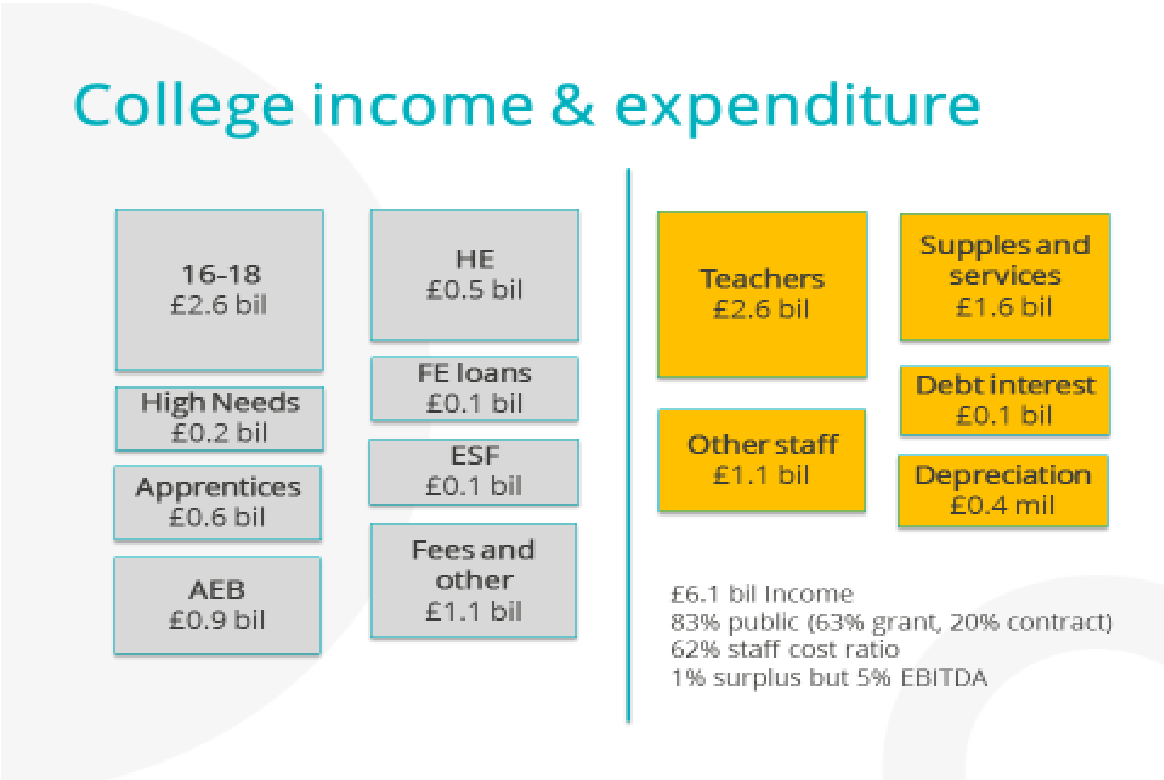
- Severe financial weakness in a small number of colleges which has affected confidence in the sector and prompted both intervention and college-to-college mergers.

- Reluctance of banks to sustain existing lending levels and lack of alternative sources of investment.

[6] Figures shared by ESFA staff but not yet published
[7] Prime Minister's speech at Derby College, February 2018

- Growing costs and liabilities associated with public sector pension schemes which are controlled by national and local government.

- Introduction of a college insolvency regime without sufficient action to stabilise the finances of the sector.



5. 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[8] or in 2009 when 80 colleges were forced to abandon capital projects[9]. The position this time is more serious because there are no easy options for improvement. There are several signs of financial strain:

   - 55% of colleges reported deficits in 2015-16[10] with the sector as a whole reporting a deficit for the third year in a row[11]. ESFA figures for 2016-17 will not be available until the end of March 2018 but we

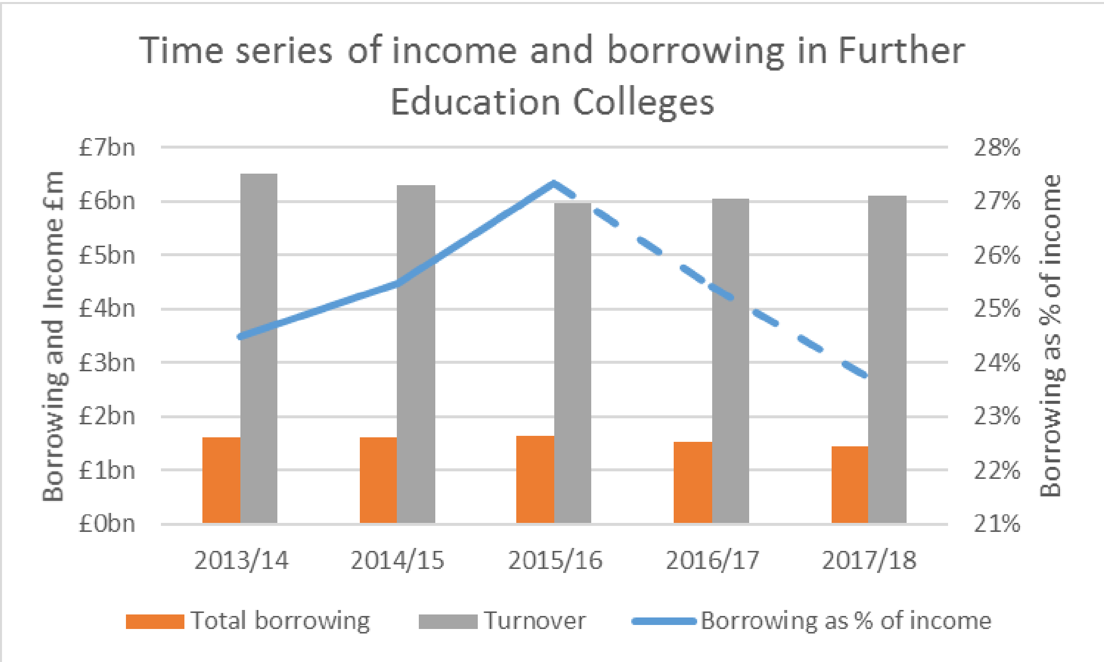
[8] Public Accounts Committee "Management of Growth in the Further Education Sector" 1998
[9] DIUS Select Committee "Spend Spend Spend" 1999
[10] AoC calculations from college accounts spreadsheet for 2015-16
[11] The surplus and deficit figures in colleges need to be treated with some caution because of the impact of volatile and unpredictable pension valuations and also transactions relating to land valuation and sale. Nevertheless Government set a benchmark that total surplus should be 3% of income in the area review programme in March 2016. Only 49 (15%) of colleges met the 3% target in 2015-16

understand that the sector is well below the area review benchmark that colleges should aim for surpluses at 3% of income.

- 68 (21%) of colleges reported earnings before depreciation interest and amortisation (EBITDA) of less than 3% of income which is the threshold in the Education and Skills Funding Agency's (ESFA's) calculation at which financial health is deemed inadequate.

- As at 31 December 2017, ESFA has issued financial notices to improve to 32 further education (FE) colleges (15% of the total) and three sixth form colleges (4%)[12]. More than half of the colleges with notices (19) have had them for more than two years.

- 15 FE colleges had exceptional financial support loans as at 31 July 2017 worth around £40 million which they needed to manage cash flow. The payment profiles used by the ESFA, Student Loans Company and new apprenticeship system leave many colleges in a situation where they need to borrow. Bank credit is now restricted. Colleges are repaying debt and cutting their debt to income ratio but this is partly by cutting capital spending.

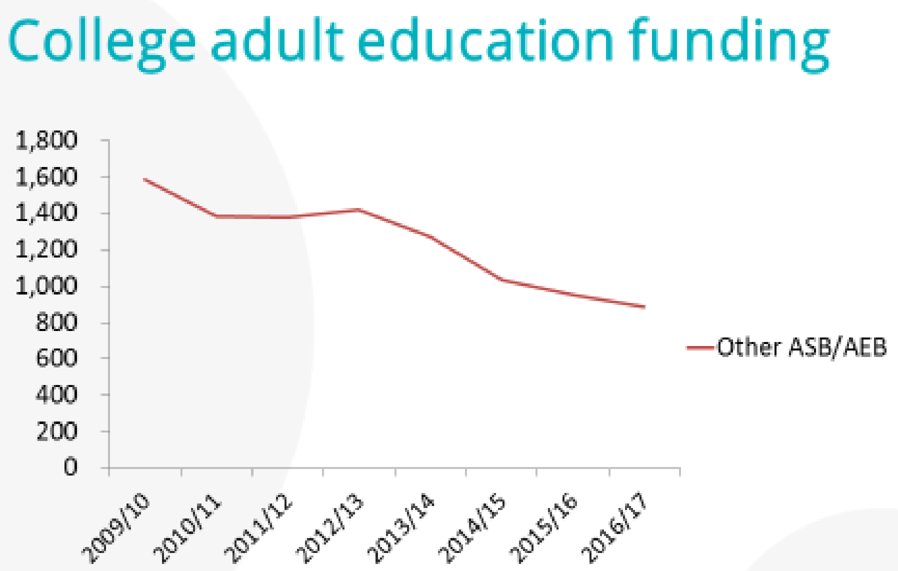


6. The context for the current situation is an eight year austerity programme which started in 2009 in the wake of the financial crisis. The position of colleges at that time was historically strong because they had become a

[12] Five financially weak colleges merged with financially stronger counterparts on 1 August so this number is lower than normal. ESFA will issue new notices to improve to some colleges following the review of financial plans returned in July 2017

destination of choice for young people, had modernised their working and had become effective vehicles to raise skills and improve productivity. In recent years, colleges have been hamstrung by the resources available to them.

7. 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[13]. The experience of funding reductions in recent years has been a cumulative series of small reductions adding up to a 27% real terms reduction in total government funding to colleges between 2009 and 2015 made up of a cash cut of 10% in the funding for 16 to 18-year-olds and cash cut of 35% in spending on adult education and skills[14]. The promise that colleges would be able to increase apprenticeship income is proving hollow because of the shift in control to levy paying employers and the low rates at which apprenticeships are funded.



College adult education (non apprenticeship) funding in £ millions reported in annual accounts

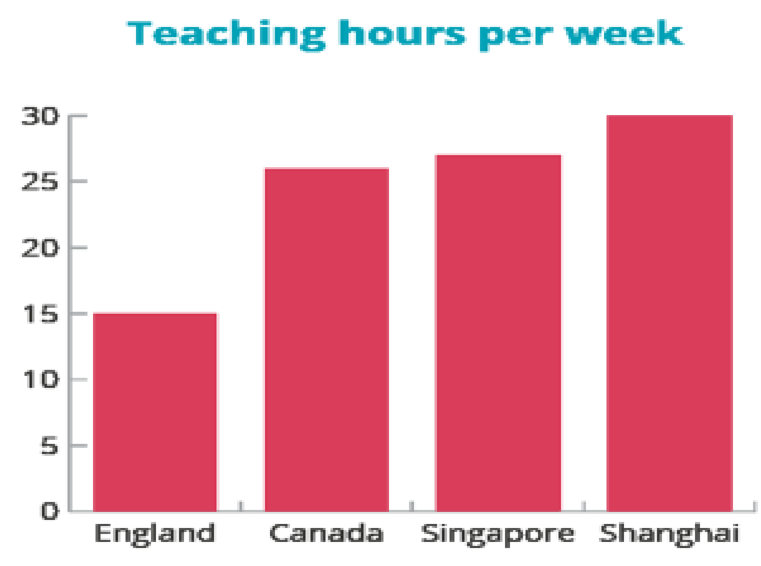
8. Given current public spending plans, overall funding from central government is likely to decline in real-terms between now and 2020. Public spending cuts lead directly to course and capacity cuts. These result in:

[13] 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
[14] AoC calculations from government spending figures. Full Fact website has more detail

- Young people having 15 hours a week teaching and support has dropped for young people to around 15 hours, compared to more than 25 in many OECD countries.

- a prolonged squeeze on pay costs. Data collected by AoC and ETF suggests average lecturer pay in colleges is £30,100 which is significantly less than average school teacher pay (£35,000) and average university academic pay (£43,000)[15]. Staff turnover rates in colleges have increased and there are recruitment difficulties in certain areas, particularly maths, engineering and construction.

- Capital investment has been cut back in line with a collective debt repayment. Total borrowing has fallen from a peak at £1.6 billion in 2014 to £1.3 billion at 31 July 2017 with clear signs that it is falling further. The main lenders to the sector are reducing their commitment. The main new lenders offer very short-term loans at high interest rates only.

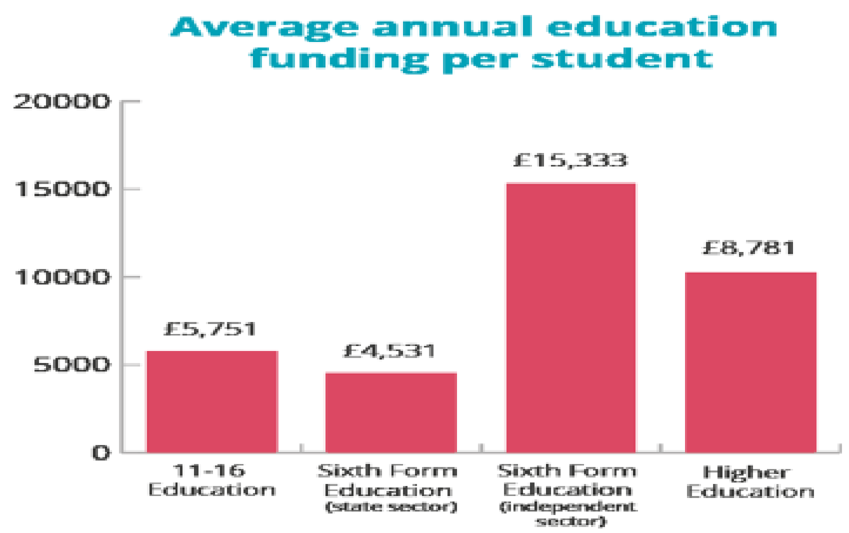


Public spending on education

[15] College figures taken from AoC Workforce Survey which was completed by 140 colleges. The school figures come from the pay review body's latest report. The university figures come from the University and Colleges Employers Association (UCEA)

9. Although colleges are being hit hard by a series of funding decisions, they are not alone in facing financial challenges. Private training providers in further education face all the funding issues listed above, though being less regulated than colleges, have more options. Many schools are under severe stress but there is a lack of clear national information on their financial position. Universities are in a much stronger position than any other education institution but the outlook is deteriorating fast.

10. Public spending on education is 4.5% of GDP in 2016-17[16] and is forecast by the Office of Budget Responsibility (OBR) to fall to 3.9% by 2021-22[17]. OBR predicts spending will stay below 4% of GDP for the long-term. 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[18] but a significant explanation of the change has been the squeeze in spending on schools and colleges. The Treasury and DfE are holding down funding at a time when the total number of pupils and students is rising[19].



[16] Public Spending Statistics 2017, Table 4.4.
[17] Office for Budget Responsibility, Fiscal Sustainability Report, 2017, Page 56.
[18] 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.
[19] DfE National Pupil Number Projections July 2016 forecast a rise in the 5 to 15 age group in schools from 6.5 million to 7.0 million.

11. The squeeze in spending involves reduction and restraint in cash allocations to state funded schools and colleges combined with policies to replace public spending with private contributions. The student loan scheme means that there is substantial private spending on degree level learning for young people. This private spending also underpins vast inequality in the resources available in to different young people and at different ages:

12. There is a positive economic case for greater spending on education and training both for individuals and employers[20]. 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[21]. 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. Regardless of what happens in other countries, the UK should be spending more on education and training than less. A longer target to raise the public education spending to 5% of GDP by 2025 would be a rational objective.

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[20] "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).
[21] Keohane, Broughton and Ketola "Working together: European Workers in the UK", SMF, June 2016.