University finances: update

On 11 July, David Willetts, minister for universities and science, confirmed a new 'operating framework' for higher education in England. This pulled together the results of various consultations and the work done by the 'Regulatory Partnership Group' to set out regulatory arrangements through to 2015.[1] A week earlier, Willetts had written to the Higher Education Funding Council for England (HEFCE): 'I recognise in the long run a new legislative framework is needed.' The government hopes that its controls on overall student numbers and the financing of HE will thus hang together until after the next election.

A few weeks earlier, in late June, the chancellor, George Osborne, had presented his 'Spending Round 2013' to the House of Commons. The accompanying plans for infrastructure investment were set out by the Liberal Democrat chief secretary to the Treasury, Danny Alexander, the following day.[2] The first document set departmental spending limits for 2015/16 and was in large part a piece of political theatre designed to set the contours for the election that falls in the second month of that financial year. The infrastructure plans cover a period commencing in 2015 and running until 2020.

The Department for Business, Innovation and Skills – responsible for universities and colleges – was apparently the last to settle its negotiations with the Treasury. After concerted lobbying, the Science budget was ring-fenced in cash terms at £4.6 billion, with the real terms cut expected to be addressed through 'Wakeham efficiencies' as the least efficient universities learn to match the 'best' in reducing indirect costs.[3]

Savings were totted up elsewhere:

1. £400 million, the final dribble of block grant to remain from the pre-2012 funding regime;
2. £60 million, through freezing maintenance grants;
3. £45 million, from an unspecified cut to HEFCE's teaching grant budget (though likely to affect the £300 million Widening Participation fund);
4. £150 million, from scrapping the National Scholarship Programme (although the name will be kept to accompany a £50 million per annum fund for *postgraduate* study to be operated through a tendering scheme).

With the last also 'match-funded' by universities, we can see that the protection for science and research has been achieved by removing grant and bursary support for the poorest students. This should be read alongside recent research by the National Union of Students which argues that bursaries for students will go down following the implementation of higher fees: from £230 million per year (2010), to £140 million per year (projected for 2015 based on Access Agreements).

Sale of student loans

In the Infrastructure publication *Investing in Britain's Future* it was confirmed that as part of planned asset sales of £15 billion, £10 billion would be found through the sale of 'corporate and financial' assets, including the 'pre-Browne Income Contingent Repayment [ICR] student loan book'. 'Pre-Browne' here marks the Coalition's disavowal of its own decision to raise the maximum tuition fee cap to £9,000 per year and relates to loans issued to those commencing undergraduate courses for the first time between 1998 and 2011. This is a new announcement that affects existing borrowers. Though plans to sell the final tranche of the 'old-style', fixed-period repayment loans were announced in March, that sale is only expected to raise approximately £200 million on outstanding balances of roughly £800 million. The latest figures from the Student Loan Company put outstanding ICR balances at £45 billion-plus for those who studied at English universities.[4] The planned sale might therefore see a quarter of that debt shifted.

The terms of the sale are as yet withheld and subject to ongoing negotiation, but this announcement appears to be consistent with what was recommended in the 2011 Rothschild review of loan 'monetization'. That feasibility study, titled Project Hero, advised that such a volume of sales could only be achieved with the removal of the current interest terms that cap the rate at either RPI or bank base rates + 1 per cent, whichever is the lower. Currently, the relevant RPI figure is that from March 2012, 3.6 per cent, while bank base rates have been 0.5 per cent since the financial crash, creating a sizeable interest rate shortfall of 2.1 percentage points. The BIS annual accounts for 2012/13 quantified the cost of the interest cap for that year alone on the loan book to be £1.6 billion in lost accrued value.

Following the publication of a story I worked on with the *Guardian*, the relevant ministers only belatedly recalled that they had ruled out 'changing terms at source'. Pointedly, they have failed to discuss the alternative recommendation made by Rothschild: the government could 'synthetically' reproduce this change by providing payments in future years to potential purchasers (insurance companies and pension funds).[5] Such a 'synthetic hedge' would mean that the government would make a loss on the sale. In return for a reduction in Public Sector Net Debt *now*, this government forgoes a future income stream and commits future budget holders to making subsidies. These would be 'backended': that is, made *after* graduates who will have benefited from lower interest rates have paid off their loans. With higher interest rates, graduates would take longer to clear their balances; additional payments would be provided by governments to mimic such extended loan lifetimes.[6]

We see again the repeated tendency of recent administrations to game the accounts by switching from current spending or capital investment to liabilities that future administrations will have to pick up or reconcile. Since the plans have been delayed two years to 2015, this could become an interesting election challenge for the Liberal Democrats.

Repayments and risk

The motivation for such a sale might be hard to follow, since the government always has the lowest cost of borrowing, but an integral part of the drive towards higher fees has been efforts to sell the resulting debt to investors.[7] This is often described as 'de-risking' the government's balance sheet: student loans are unsecured and have unusual repayment patterns that are sensitive to economic and earnings downturn.

In the last six months, official estimated losses on the new iteration of the scheme have clicked upwards from 32p on each £1 lent to 35p: once all undergraduate years are on the new regime, each percentage point 'uptick' would represent an additional £100 million impairment on the departmental expenditure account.

Annual loan issuance in 2015/16 will be about £12 billion (split 35:65 between maintenance loans and tuition fee loans). In contrast, total annual repayments for 2012/13 were depressed at £1.4 billion: £0.6 billion below the Office for Budgetary Responsibility's forecasts.[8] A mature, sustainable loan scheme is one where annual issuance is matched by annual receipts. These figures indicate that such stability is even further off than previously thought.

Outgoing head of HEFCE Alan Langlands, who leaves to become the vice chancellor at the University of Leeds, warned that the rest of the world sees the reforms being undertaken in England as 'completely bonkers': 'If [the government] have got their sums wrong on some of this – or some of their underlying assumptions wrong … that is when the trouble starts', he told a conference in April.[9] More recently, Andreas Schleicher from the Organization for Economic Cooperation and Development clarified that his comments about England having probably 'the most advanced system' of student support related to the 2006 reforms, not those of 2012. This undercuts one of David Willetts's defences.[10] (Even in 2010, OECD assessed that only Chile used a higher percentage of private funding in higher education, although the National Audit Office is currently reviewing how to classify tuition fee income supported by student loans.)

Rothschild switched their attention to selling earlier years of the 'pre-2012' loans precisely because those graduates were in better jobs when the recession hit and because the loans issued to new starters since September look too risky for commercially minded investors.

The policy implications of all this are obvious. Maximum fees are frozen until 2014/15, though average fees after waivers will increase to £8,500 that year. The Institute for Public Policy Research, a centre-left think-tank, recommended extending the freeze for a further three years and riding the coming demographic blip by keeping the *proportion* of youngsters heading to university full-time constant but letting the actual numbers slide.[11] There is obviously no guarantee that this reduction would be distributed evenly across institutions.

When aligned with further liberalization in the 'high grades' policy (clicked down one notch to ABB) and the complex and little-covered redistribution of places proposed for 2014/15, the 'squeezed middle' of English higher education institutions looks even more compressed, pushing issues of institutional governance and decision-making to the fore. Willetts's letter to HEFCE included a sentence that was not reproduced in the public statement: 'I recognise the importance of [the HEFCE Financial Memorandum] for sustaining confidence in universities in the capital markets.' That same week, the University of Manchester issued a £300 million bond.

Concerns about loan outlay returning as repayments has already seen a major change in policy: new private 'providers' will be subject to student numbers controls from 2014/15 as a condition of their students gaining access to maintenance grants and loans. In 2011/12, such support amounted to over £100 million and looks set to double for 2012/13 as tuition fee loans have increased to a maximum of £6,000 per year. New controls will be determined by recruitment levels in 2012. A significant exception is that those who made large capital investments prior to the government's announcements in March and April may apply for a higher 'cap'. Likely candidates here include Greenwich School of Management, students at which accounted for over one-fifth of all support accessed in 2011/12: £22 million (£5.5 million in grants). GSM is owned by Sovereign Capital, a private equity firm active in training and health care. It was co-founded by John Nash, who remains non-executive director for education; since January, he is Baron Nash, Conservative peer and parliamentary undersecretary of state for schools.[12]

More drastic options include generating higher levels of repayment by changing the terms on the 2012 loans, possibly for current students. Treasury officials apparently entered the Spending Round negotiations by asking for the repayment thresholds on new loans to be reduced to £18,000 from £21,000.[13] An anonymous vice chancellor was quoted in May: 'There is quite a lot of evidence that students and parents don't really understand the new financial system, so you could play around with it quite easily.'[14] Quite what goodwill remains towards universities after all this will be hard to locate.

As for the electoral jockeying, the Spending Round has been politically successful in corralling Labour into accepting these overall constraints, at least for 2015/16, much as they did seventeen years ago, when Kenneth Clarke set up spending limits for 1997/98. Labour's 'pledge' to reduce the maximum tuition fee to £6,000, then, turns complex accounting into a core policy issue as attempts are made to shuffle bits of expenditure around. A footnote buried away in the Spending Round showed that the 'impairment' set aside in departmental accounts for the non-repayment on loans would leap from £2.9 billion (2014/15) to £4.4 billion (2015/16).[15]

This is a leaving present that puts Liam Byrne's 'empty coffers' letter into perspective. The current HE funding regime is clearly unsustainable, but no one appears willing to fix it under current electoral, parliamentary and fiscal conditions.

Notes

1. The relevant documents can be found on the HEFCE website: www.hefce.ac.uk/news/newsarchive/2013/name,82681,en.html.
2. HMT, *Spending Round 2013*, 26 June 2013, www.gov.uk/government/uploads/system/uploads/attachment_data/file/209036/spending-round-2013–complete.pdf; HMT, *Investing in Britain's Future*, 27 June 2013, www.gov.uk/government/uploads/system/uploads/attachment_data/file/209279/PU1524_IUK_new_template.pdf.
3. www.rcuk.ac.uk/research/Efficiency/Pages/efffaqs.aspx.
4. Student Finance England, *Statistical First Release*, 25 June 2013, www.slc.co.uk/media/589340/slcsfr012013.pdf.
5. See Aditya Chakraborrty, 'Raise Interest Rates on Old Student Loans, Secret Report Proposes', *Guardian*, 13 June 2013, www.guardian.co.uk/money/2013/jun/13/raise-interest-rate-student-loans-secret-report; Andrew McGettigan, 'Project Hero Gets a Zero', *False Economy*, 14 June 2013, http://falseeconomy.org.uk/blog/project-hero-deserves-a-zero-comment-on-our-student-loans-interest-increase.
6. Note that, because these are *income contingent repayment* loans, higher interest rates do not translate into higher *monthly* repayments. Higher interest rates keep people making repayments *for longer* or mean that 'policy write-offs' wipe off larger balances (twenty-five or thirty years after repayments first fall due or at retirement depending on when students first signed up).
7. For an account of this history, see Andrew McGettigan, *The Great University Gamble: Money, Markets and the Future of Higher Education*, Pluto, London, 2013, ch. 13.
8. Office for Budgetary Responsibility, *Economic and Fiscal Outlook*, March 2013, footnote 1, Table 4.30.
9. John Morgan, 'Are English Funding Reforms Bonkers?' *Times Higher Education*, 25 April 2013, www.timeshighereducation.co.uk/news/are-english-funding-reforms-bonkers/2003446.article.
10. John Morgan, 'OECD: Opening the Market Door Will Prove Costly', *Times Higher Education*, 27 June 2013, pp. 6–7.
11. IPPR Commission on the Future of Higher Education, *A Critical Path: Securing the Future of Higher Education in England*, June 2013, http://ippr.org/publication/55/10847/a-critical-path-securing-the-future-of-higher-education-in-england.
12. See Andrew McGettigan, '"New Providers": The Creation of a Market in Higher Education', *Radical Philosophy* 167 (May/June 2011), pp. 2–8.
13. Despite the compromises reached with the Liberal Democrats in 2010 to increase the threshold in line with earnings from 2017, these regulations have yet to be made, meaning that it is likely to be frozen.
14. Anna Fazackerley, 'Student Loans: Will It Soon Be Payback Time?', *Guardian*, 6 May 2013, www.guardian.co.uk/education/2013/may/06/student-loans-repayment-level-lowered.
15. HMT, *Spending Round*, p. 59, footnote 5, Table A1.