Scottish Funding Council
Comhairle Maoineachaidh na h-Alba

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Benny Higgins
Chair
Advisory Group on Economic Recovery

AGER@gov.scot

Dear Mr Higgins,

Call for views

Thank you for the opportunity to provide input to the work of the Advisory Group.

The Scottish Further and Higher Education Funding Council (SFC)

SFC is the national, strategic body for funding teaching and learning, research, innovation and other activities in Scotland's 26 colleges and 19 universities and higher education institutions. SFC is a Non-Departmental Public Body (NDPB) of the Scottish Government. Our ambition is for Scotland to be the best place in the world to learn, educate, research and innovate, so that all of our nation can flourish. Our purpose is to create and sustain a world-leading system of tertiary education, research and innovation that changes lives for the better, enriches society and supports sustainable and inclusive economic growth.

Context

There is no doubt that COVID-19 presents a unique and significant external shock to society, the economy, and the further and higher education system in Scotland. Our immediate priority as a Funding Council has been to provide assurances of stability and continuity.

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Financial impact on further and higher education

We have also undertaken detailed analysis of the impact of the COVID-19 emergency in both the immediate and medium to long terms on both the college and university sectors. Our briefing, a copy of which I have attached, sets out an early analysis of possible financial impacts. This is a dynamic and complex situation. Our analysis will develop as funding availability, mitigation strategies, and responses to the pandemic come into sharper focus. SFC continues to engage; provide stability and flexibility in funding flows; support students; and work closely with governments, funding and regulatory counterparts across the UK, and other key stakeholders.

Skills and economic recovery

Furlough and the job retention scheme are masking the true impacts of COVID in relation to the economy and the labour market. However, we do know that over the coming weeks and months, a proportion of the work force will be impacted and in the near term, there will be a greater need for upskilling and re-skilling provision to support people to get back into the labour market.

High skilled professional jobs may be better insulated from some of the effects of COVID-19. We may see a disproportionate impact on lower skilled jobs through customer facing positions more vulnerable to job losses. There have already been widespread job losses and hospitality, retail (with the exception of food retail) and tourism businesses are likely to see the greatest impacts on labour supply and demand.

The Institute of Fiscal Studies suggests:

- young workers will be hardest hit - employees aged under 25 were about two and a half times as likely to work in a sector that is now shut down as other employees.
- low earners are seven times as likely as high earners to have worked in a sector that is now shut down.
- women were about one third more likely to work in a sector that is now shut down than men.

Geographically, rural regions and economies are likely to be less resilient due to the high levels of SMEs within these areas.

University and college provision needs to respond to these challenges with innovative, flexible (and short and sharp) solutions, driven by the data and evidence and underpinned by informed, effective and intelligent planning. Outside of the near term, given that there is going to continued and longstanding pressure on public resources given the number of fiscal interventions required, a renewed focus on economic and social outcomes is even more important to ensure we're maximising the benefits for Scotland plc from our investment in the education and skills system.

Yours sincerely,

Donna MacKinnon
Director of Access, Learning & Outcomes

COVID-19 Further and Higher Education Financial Impacts

University sector

- In this Academic Year (AY) 2019-20, Scottish universities face a loss of around **£72 million** due to COVID-19
- In optimistic scenario one, where the normal intake of new international students drops by half, Scottish universities face a collective operating deficit of **£383.5 million** in AY 2020-21.
- In pessimistic scenario two, if there is a complete drop in new international students in AY 2020-21, universities could face an operating deficit of **£651 million.**
- Even allowing for some new and returning international students, and further mitigating actions by institutions, we might still expect a significant deficit of at least **£450-500 million**.
- COVID-19 will have cumulative, multi-year impacts well beyond AY 2020-21.
- All 18 Scottish universities will go into deficit in AY 2020-21 (analysis does not include OU Scotland)
- While there are sector-wide COVID-19 impacts, each institution will be affected differently.

1. The COVID-19 crisis presents a unique and significant external shock to the higher education system in Scotland and it is unlikely that the scale of losses in Academic Year (AY) 2020-21 can be bridged by universities at their own hand. We expect COVID-19 will have cumulative, multi-year impacts:

   - The OBR calculates that education will take the single hardest hit, with 90% of output affected.
   - The higher education sector across the UK is particularly exposed to a fall in international students compared to other countries, as international students account for a higher proportion of our student bodies than most other countries.
   - The current funding arrangements in Scotland have encouraged the growth of international and rUK students to cross-subsidise home student tuition, research activities and PhD students that are not funded at full economic cost.

2. We asked universities to tell us their overall financial position if there was a 50% reduction in new international student intakes and a reduction of 30% in international students continuing studies for AY 2020-21. Many universities are modelling 100% reductions in new intakes. Beyond the next AY, there are cumulative annual effects from reduced international student intakes, with many institutions modelling 25-50% reductions in new intakes in 2021-22; 10-25% reductions in 2022-23; and 5-10% reductions in 2023-24. This is a dynamic situation and universities will be considering further mitigation strategies as it evolves. Their governing bodies will start making decisions about budgets and staffing for 2020-21 from mid-May.

3. In AY 2019-20 the sector's overall operating position is expected to reduce by **£72 million** on pre-COVID19 forecasts, to a surplus of £166.5 million. However, based on scenario one (50% drop in new international intakes) this position is expected to deteriorate further in AY 2020-21 to **an operating deficit of £383.5 million,** a reduction of £550 million from the previous year after accounting for a small USS credit in that year. Nine universities had projected deficits before the COVID-19 outbreak. This has increased to 12 in the revised forecast for AY 2019-20 and it is anticipated that **18 universities will report deficits in AY 2020-21** (our assessment does not include Open University Scotland). Scenario two (100% drop in new international student intakes) would result in a further reduction of £267.7 million, increasing the sector **operating deficit to £651 million** in AY 2020-21. Even allowing for some new and returning international students, and further mitigating actions from institutions, we might still expect a significant deficit of at least **£450-500 million**.

4. The main negative financial impacts on surpluses relate to:

   - Tuition fee contribution reductions in overseas, rUK and short course provision.
   - The fall in stock markets and pressures on the local and global economy leading to significant drops in regular donations and income from endowments.
   - Commercial income reductions from residence income, catering and sport.
   - Research activities affected by closures.
   - Additional costs from IT and support costs to support online teaching, and assessment and feedback, along with contract costs associated with the suspension of work on campus redevelopment programmes.

   We have yet to capture fully how overseas campuses affect an institution's financial position.

5. Based on scenario one (50% drop in international intakes), sector cash balances are forecast to deteriorate by £636 million (42%) to £877 million by July 2021. Cash balances would deteriorate by 60% to £609 million under scenario two (100% reduction in new international student intakes).

6. Three universities are projecting to move into a negative cash position by the end of AY 2020-21. The forecast net overdraft position for the three institutions amounts to around £54 million. Cash balances may be artificially inflated by unspent funds, for example, unspent borrowing for capital projects. Universities will have borrowed for different purposes. For some, their borrowing will be tied to their capital programme, and therefore this borrowing cannot be used to sustain operations. That is a condition of borrowing with some lenders. So the cash position of institutions needs to be set in the context of their inability to vire cash to sustain their operations without their lender's permission.

7. Five universities are forecasting negative net cash inflow from operating activities (pre COVID-19: two universities) and this increases to 15 universities showing net cash outflow from operating activities in AY 2020-21.

8. Across all universities, the sector net cash inflow from operating activities as a proportion of total income (a measure that captures the financial health of an institution in terms of its day-to-day operations) has moved from +4% in the pre-COVID forecast to +3% in the revised forecast for AY 2019-20. This reduces to -4% in AY 2020-21. This ratio would deteriorate to -12% on the basis of a 100% reduction in new international intakes.

9. Borrowing at the end of AY 2019-20 is forecast to increase from £1,687 million pre-COVID to £1,740 million, with five universities forecasting additional borrowing in the current year. In AY 2020-21, borrowing is forecast to increase by £20 million to £1,760 million with four universities undertaking additional borrowing. Sector borrowing is forecast to increase from 40% of total income in AY 2019-20 prior to COVID-19 to 45% of total income by the end of AY 2020-21.

10. In terms of other major uncertainties, liability for paused research projects remains unclear and universities are uncertain about the impact of COVID-19 on rUK and EU numbers, and whether funding for EU students will continue in future years. Some institutions have not factored in reductions in accommodation income in 2020-21 as they expect rooms may be filled by second and third year returning students. Universities also project a reduction in income, donations and endowments over the planning period.

11. Mitigations to date include:

- Deferring work on maintenance.
- Deferring decisions on capital works.
- Furloughing staff through the UK Coronavirus Job Retention Scheme (CJRS); to date, mostly commercial staff and a small proportion of research staff only.
- Implementing a recruitment freeze or mission-critical recruitment only, no salary increments, staff redeployment and possible redundancies, with a concern that this may be harmful to a university's ability to recover and operate in future.
- Restricting consumables spend to critical expenditure only.
- Cost cutting reviews to identify savings across all areas of the business.

12. Several universities have highlighted that cash levels could become critical towards the end of AY 2020-21. For some this is despite taking mitigating actions and for others it is due to concerns that mitigating actions will not produce the planned results. Some are planning to use revolving credit facilities to provide cashflow support in the short to medium term. In addition, some universities will seek to access the UK COVID Corporate Finance Facility (CCFF) and/or the Coronavirus Large Business Interruption Loan Scheme.

13. Many institutions have indicated that it is likely that covenants will be breached, particularly in AY 2020-21 and have engaged at an early stage with lenders, including developing an understanding of the additional facilities that may be available. Indeed, short term CCFF and revolving credit facilities may lead to breaches in financial covenants. In the absence of agreement on covenant changes, universities may seek further medium term borrowing within financial covenant restrictions, although this would come at a higher cost.

Impact on research

14. Research in universities is, in general, undertaken at a financial loss, in that the funding of research rarely covers the full economic costs (FEC) of doing the research. For example, the UKRI Research Councils fund at no more than 80% of FEC. While the quality-related funding (the Research Excellence Grant) from SFC assists, our funding is also used to support new research areas and the training of PhD students, giving an overall sectoral recovery of research costs in Scotland of 78% of FEC. The balance of costs (£366M in AY 2017/18) is supported, typically, from the profits from international student fees. So, a drop in international students affects research activity.

15. SFC is carrying out a survey of Scottish universities to assess the immediate and longer term impacts of the COVID-19 emergency on research. At the halfway point of the survey, we know that the transition to closed labs and home working has been achieved smoothly, with a wide variation in research continuing. In subjects like chemistry, biology, general medicine, veterinary and physics (where access to labs or equipment is required) research activity is operating at roughly 20-30%; engineering, arts and humanities at around 50-60%; with informatics and maths at around 90%. Activity will decrease as tasks that can be performed remotely are completed. In the short term, the main impacts are cash-flow from paused grants; disrupted recruitment and inhibited staff retention; and the interruption of research. This is likely to be compounded by significant falls in annual funding from charities and industry, amounting to tens of millions of pounds of research funding.

16. In the medium term, predicted impacts are a significant loss of research momentum, a reduction in the volume of new research grant awards from some funders and the creation of a "lost generation"

of PhD students and post-docs whose work will be blighted. In the longer term, universities are highlighting the impact from the start of the new AY being a varied, but in the case of our research intensive universities dramatic and sustained, risk to research capacity which, if not externally compensated for, will lead to hard sustainability choices being faced by universities, a loss of capacity and reputation, and a more limited ability to contribute to the post COVID-19 economic recovery. An unmanaged, significant reduction in research capacity, could lead to many staff losses and we may lose the ability to prioritise research and innovation that matters to Scotland's future. A more strategic, managed reshaping of the research base, over several years would help to preserve key activities that matter.

17. In addition, the full impacts of the end of the transition period following Brexit are still unknown as it is still not clear whether the UK will associate to Horizon Europe or otherwise secure partial access to EU research and mobility programmes. The combined effects of Brexit and COVID-19 on research funding and mobility will place Scottish universities in a particularly challenging position.

18. The UK Government's CJRS furloughing scheme is being used though, at the time of writing, some ambiguity remains in the applicability of that to the researchers supported by UKRI. SFC is open to the potential to re-profile our core grants, including REG, to ease cash-flow as we enter the new AY.

Why should we help universities?

19. Universities face a unique external shock that stretches beyond their existing financial capacity to fix. If they are not supported with transitional funding and time to adjust we may lose key national assets and capabilities, including significant international connections. Without time to make the right decisions for Scotland, they may focus on institutional survival alone. They may make decisions with profound consequences for Scotland's economic recovery, research and innovation base, prospects of meeting net zero carbon ambitions, and pipelines of talent for our future workforce.

20. It is unlikely that the international student market will bounce back quickly or in its pre-COVID form, but we must not assume it is lost entirely. Scottish higher education institutions have an outstanding international reputation, and if Scotland can remain a safe, clean, attractive place to study and research, and if young people from India and China, and many other countries, continue to want to study abroad, then there is potential for recovery in the international market. There will be a growth in on-line and remote learning and research collaborations, and we need to reconsider a model that is so highly geared to international and rUK student income, but we should assume that, in time, people from other countries will want to come to Scotland to study and work. This is why bridging support matters – to enable a re-growth of such important international connections that matter for our society, economic prosperity, and student experience.

21. This is not about committing to the current arrangements or constructs – the sector and institutions will need to adapt and adjust. While we recognise that universities need time to do this, as this is a unique shock, a support package provides the opportunity to respond to global change, reconsider the contract between universities and public investment, the shape of provision, and re-establish what we need from universities and tertiary education within Scotland.

College sector

- For this AY2019-20, Scottish colleges face a loss of around **£25 million** due to COVID-19
- All but three colleges are now forecasting deficits in AY 2019-20.
- The impact in AY 2020-21 is expected to be even more severe.

22. We are working with colleges to establish more accurate forecasts. The full financial impact will be better understood when there is greater clarity about European Social Fund (ESF) activity targets (SFC can only claim ESF activity once the sector has delivered the core 116k FTE target) and income recognition for Flexible Workforce Development (FWDF) and Skills Development Scotland (SDS) funding. Several colleges have reported shortfalls against core activity and ESF targets, mostly related to the COVID-19 outbreak. We are encouraging colleges to account for all relevant remote activity for 2019-20 against targets. In addition, colleges have yet to reflect the full potential impact of accessing the UK Coronavirus Job Retention Scheme (CJRS) and approaches currently vary across the sector.

23. The financial position of colleges was already challenging pre-COVID. The impact of the COVID-19 outbreak on colleges' financial sustainability is significant. **The 2019-20 sector adjusted operating position is expected to move from a near break-even position to a deficit of £25 million. Six colleges had projected deficits pre-COVID; however, only three colleges (two of which are non-incorporated) are now forecasting surpluses.** Many colleges believe the impact in 2020-21 will be more severe.

24. The main COVID-19 financial impacts include lower income from the following funding streams: ESF; FWDF; tuition fees and education contracts; SDS; nursery; accommodation; catering; short-courses including evening classes; and other commercial activity including international income.

25. The majority of colleges' costs are staff costs which continue to be met for the most part, subject to greater consideration of successfully accessing the CJRS for the portion of college activity that is not supported by public funds. Colleges will generate savings in these areas: academic materials and consumables; utilities; property costs; photocopying; and travel and subsistence. They are incurring additional costs related to online learning and remote working. Student support does not appear to be a cost pressure on the basis of the information returned to us. Repurposing student support funds to hardship funds seems to have helped address this particular cost pressure, although we are keeping this under constant review.

26. **Sector cash balances are expected to move from £40.8 million (FFR) to £28.4 million (MYR)** by the end of AY 2019-20. Six colleges are projecting to move into a negative cash position by the end of the AY. The net overdraft position for the six colleges amounts to around £3 million, noting that cash balances may be artificially inflated by unspent funds, for example, from high priority maintenance funds.

27. Fourteen colleges are forecasting negative net cash inflow from operating activities in AY 2019-20, up from nine last year. Across all colleges, the sector net cash inflow from operating activities as a proportion of total income has moved from 3% in the original forecast to 0% in the revised forecast for AY 2019-20. This measure provides an indication of the financial health of an institution in terms of its day-to-day operations, as it does not include any items of non-cash expenditure (such as depreciation, amortisation and (most importantly) adjustments for pension liabilities), or income

from and expenditure on financing activities.

28. Several colleges have delayed the implementation of voluntary severance programmes as a result of the pandemic. These programmes were being taken forward by colleges in order to secure their financial sustainability prior to the outbreak of COVID-19.

29. Further mitigating actions that colleges may consider to address liquidity challenges include requesting banks to delay loan repayments on pre-April 2014 loans, seeking Time to Pay agreements for HMRC tax, and deferring VAT payments, in line with HMRC guidance. At this point, no college has referred to bank covenants being breached.

Why should we help colleges?

30. While the college sector does not face the same absolute scale of impact compared to the university sector, Scottish colleges do not have the range of financing options available to universities, so their position could also be critical. Most immediately, there needs to be greater clarity about European Social Fund (ESF) arrangements, income recognition for Flexible Workforce Development (FWDF) and Skills Development Scotland (SDS) funding.

31. If colleges are not supported and given time to adjust we may lose key national assets and capabilities. Colleges will be instrumental in economic recovery strategies, working with the small and medium enterprise business base, upskilling and reskilling, and fulfilling their civic roles as local anchor institutions.

32. This is not about committing to the current arrangements – the sector and institutions will need to adapt and adjust, to collaborate and to ensure we have a tertiary system that meets Scotland's needs.

What SFC is doing on financial sustainability

- Continuing to track and assess financial impacts through a fluid and dynamic time.
- Making funding allocations to bring stability and continuity, to enable staff to be paid, research to continue, and students to be supported.
- Offering flexibility in reprofiling grant drawdowns to ease cashflow concerns where possible.
- Providing additional guidance and joining up with other agencies to provide clarity where needed on programmes and funding.
- Reviewing all our non-core funds to assess our ability to repurpose funds.
- Exploring the use of Financial Transactions and shared missions with other funding bodies.
- Keeping in close contact with the Scottish Government and UK counterparts and networks on potential support packages, and on the implications of interventions in further and higher education in rUK that affect Scotland.

Scottish Funding Council, 29 April 2020