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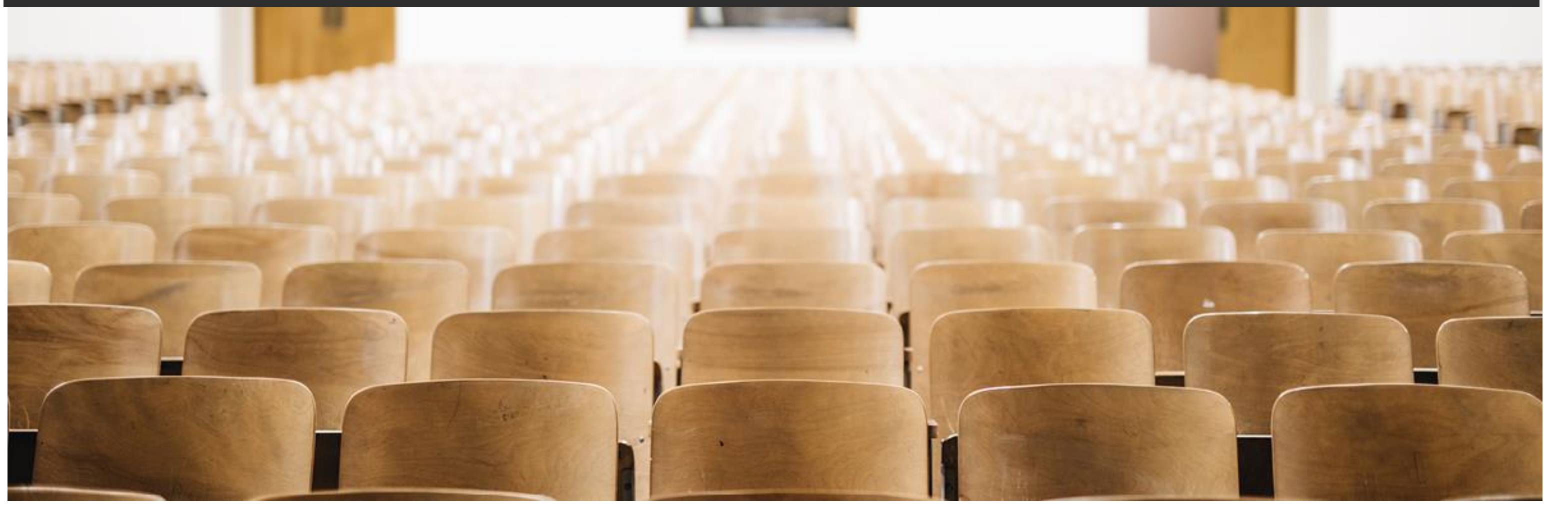
Alert | Restructuring & Bankruptcy



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Britain's Renowned Higher Education Institutions Face Financial Headwinds, Potential Insolvency

British universities facing financial challenges and shifting enrollment patterns are considering restructuring plans in light of potential insolvencies.

Revered for their academic excellence and preeminent research facilities, the universities in England, Wales, Northern Ireland, and Scotland have a collective annual revenue of over £48 billion, largely from fees and expenses paid by international students. They also support more than 100,000 jobs across the United Kingdom. Among them are some of the world's oldest universities, none of which have gone insolvent. However, in recent times, macroeconomic factors have caused a steady financial decline for many higher education institutions, with one in four now in the red. Many of those struggling include the post 92 "modern" universities together with a handful of the "Russell Group" indicating some level of distress.

What has caused this financial distress?

Factors Exacerbating the Challenges Faced by Universities

- Tuition fees for domestic students in England and Wales have been held at £9,250 since 2017 and £1,820 for domestic students in Scotland since 2022.

- A-Level students, particularly in the northeast, are turning their backs on studying for a degree due to a stagnant job market, high costs of accommodation, and strikes affecting tuition in recent years.
- Some universities (primarily the modern institutions) are statutorily obliged to be members of the Teachers' Pension Scheme. The affected universities must pay pension contributions for their staff members, and that contribution rate has risen from 16.4% in 2019 to 29% today.
- Recent changes to UK immigration policies have deterred international students from studying in Britain. As of July 2024, applications for sponsored study visas have fallen by 16% year on year, resulting in 81% fewer applications by dependents of students year on year.

Additionally, undergraduate tuition fees for domestic students have not risen significantly since 2012, and not at all since 2017. In a decade of high inflation, universities now lose, on average, £2,500 per year on every domestic student. Many universities now heavily rely on international students to plug the gap. Since statutes do not limit fees for international students, they can typically pay anywhere between £22,000 to £40,000 a year in tuition fees alone. In 2022, one fifth of all UK university revenue derived from international students' tuition fees.

67 Institutions Carrying Out Redundancy and Restructuring Programmes

As a result of these factors, 67 higher education institutions are carrying out redundancy and restructuring programmes, which may lead to bitter disputes with the University and College Union (UCU). Meanwhile, the UCU has written to the Labour government requesting an emergency rescue package. But Education Secretary Bridget Phillipson has ruled out bailouts for universities in financial distress even though the UCU has warned that "anything short of an emergency rescue package for the sector will be insufficient to stave off catastrophe."

Many of those 67 institutions are members of the Russell Group. Whilst redundancy and restructuring programmes vary across the institutions, job cuts and the closure of non-performing departments may be prevalent in the coming years. Many modern institutions are now highly indebted, due in part to these universities turning to the capital markets to fund investment for infrastructure and research. Except for a handful of top-tier universities, most cannot sell public bond deals, and with the European Investment Bank halting new loans due to Brexit, many universities turned to the private placement note market as a source of capital. Highly geared institutions may turn to private equity, which may be interested in acquiring universities at a knock-down price. This may lead to more higher education institutions becoming "for-profit" with the ability to charge market-rate tuition fees for domestic students.

Meanwhile, the universities regulator, the Office for Students, has announced a contract of up to £4 million for professional services companies to help manage the potential wave of insolvencies. The aim would be to facilitate restructurings of failing universities and, in the more extreme cases, manage "potential market exits." A number of institutions may shut down unless they dramatically cut costs or merge in the next few years.

Impact on the Student Accommodation Market

The student accommodation market may also face significant repercussions. High student numbers, strong operational metrics, and a persistent supply-demand imbalance have meant the purpose-built student accommodation (PBSA) market has remained a robust and attractive one for investors. However, any major shifts in enrolment patterns caused by a decline in international students or the potential closure of universities could impact occupancy rates and potentially challenge the market's resilience.

Universities' financial instability is not the only factor impacting this market. Elevated construction costs, stringent planning regulations, and high debt costs are all hindering new developments of PBSA, exacerbating an existing shortfall and pushing up rents for existing stock. This may be acutely felt by students, some of whom may already be rethinking decisions to pursue higher education for a variety of reasons.

The sector is also in flux due to potential legislative changes. The new Labour government has not revealed whether its Renters (Reform) Bill, which will end no-fault evictions and reform grounds for possession, will include exemptions for the PBSA and private student housing sectors, both of which rely on the cyclical nature of the short-term student letting business model and the ability to guarantee possession at the end and start of each academic year. In addition, existing investors also face significant Capex requirements to upgrade and refurbish older PBSA assets to comply with new regulations, such as those related to building safety and energy efficiency standards.

The private student housing market, where there is a shortage of houses for multiple occupation (HMOs), is also feeling the impact of high interest rates and increasing regulation, placing upward demand pressure on the PBSA sector. Universities managing their own accommodation face additional pressures because, unlike PBSA operators who can utilise flexible renting models with short-stay options during off-peak periods to boost net operating income (NOI), universities are often prevented from such arrangements due to planning restrictions resulting in significant periods with little or no rental income, adding to the financial strain.

Although the UK PBSA market has shown resilience by adapting over the last few years to a changing landscape, the risk of university closures may impact future stability if the sector does not demonstrate continued adaptability and an ability to generate returns amidst evolving external factors.

Conclusion

Many higher education institutions in the UK face an existential crisis, and absent private investment or government intervention, insolvency may be a realistic possibility for universities up and down the country, which in turn will have a knock-on effect on the PBSA market.

Whilst the government is unlikely to undertake a nationwide bail-out of universities in the short term, the Labour party pledged to overhaul the funding settlement and to "create a secure future for higher education and the opportunities it creates" in its election manifesto. It is unclear what that overhaul would look like, but one short-term measure would be to increase tuition fees for domestic students.

Universities may also continue turning to the private debt market in a bid to raise short-term capital and pay maturing debts, but refinancing existing debt may prove to be challenging for all the reasons set out above.

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