Addendum to questions from finance webinar

After the webinars were delivered, UCU has circulated a 'Scoping report for union branches University of Sussex'. This was written by an external author who did not attend the webinars, where many of the speculative areas in the report were clarified. The conclusions of the report are unnecessarily pessimistic in some areas and the University would expect to produce a far better outcome than some of the actions proposed in the report, in particular in our relationship with lenders. We do not intend producing a point-by-point commentary on the report, but we are happy to offer clarification in addition to the webinar of some areas discussed in the document.

Loans and borrowing

How does the University approve loan agreements?

The power to enter into loan agreements with banks or with other institutions is reserved to Council. It is not within the power of the Director of Finance or the University Executive Group to enter into loan agreements. As would be expected with major long-term commercial agreements, there is significant scrutiny of every loan agreement which the University enters into, ensuring compliance with Council's own borrowing policy which is reviewed every few years. In the case of the current Barclays loan and Lloyds loan, Council made the decision after scrutiny from a Council subgroup chaired by the Treasurer, which recommend acceptance to Council. In the case of the Private Placement in 2017, the matter was discussed fully with a detailed briefing and question and answer session for Council committee members with our external financial and legal advisors. The matter was then the subject of SPRC discussion and recommendation, followed by Council discussion and approval. Full approval by HEFCE (our regulator at the time) was received prior to both, adding a further level of scrutiny and sign-off of the loan.

How did the set of lender financial covenants arise and get approval?

The financial covenants in our Private Placement mirror the covenants in earlier agreements. It is a commercial reality that a new lender offering money will not agree to lend on worse terms than existing borrowers, and so the terms in 2017 for the Private Placement mirror the 2009 bank agreements with very minor and benign variation. The 2009 covenants were an improvement on earlier outdated covenants that mirrored HEFCE rules on monitoring and which were not practical for long-term non amortising debt. The University's Council approved after detailed discussion, recognising the opportunity to agree a simplified covenant set at that stage. We can be clear that there was no commercial opportunity to reset financial covenants on the 2017 Private Placement as lenders would not lend money with less protection than existing lenders (Barclays and Lloyds). The covenant set that the University has is simple and straightforward compared to many (though most covenants are commercial terms which are not published), and we know that we have acceptable covenants from advice through financial and legal advisers and informal discussions with peer HEIs. Annual testing of covenants is common for the obvious reason that a lender's rights to protect their lending would be severely diminished if a sequence of bad results over a period of years were to arise. As noted, the University's covenant set was scrutinised and approved by Council as part of the various borrowings over the last 20 years.

Is there an option to repay loans and would it be beneficial?

This question was answered at one of the webinars but is restated here to be clear. The Private Placement and the Barclays loan are fixed interest loan instruments. Fixed interest loan instruments contain protections for the lender for the interest which they were expecting to earn, and in many cases they will have committed to pay interest charges themselves on funds which they have borrowed to lend to us. The costs of ending the loans early ('break costs' as they are termed in loans or 'make whole payments' in Private Placements) are calculated according to contractual commercial agreement. These will be similar across typical contracts, including public bonds issued by other universities. They are based on a calculation of capital plus future interest due subject to financial adjustments to allow for the fact that repaying capital will allow the lender to place the money in low risk gilts, for example. Early repayment of the Private Placement (and Barclays) loan would trigger very significant termination costs in the tens of millions of pounds and would make no sense for the University as it would not only crystallise accounting losses but, more significantly, deplete our cash balances by repaying both capital and incurring huge costs of breaking the loan. It is highly unlikely that the University would contemplate repaying such fixed interest borrowings unless it were part of a restructuring of loan agreements, which can be beneficial in certain circumstances. Moreover, the University borrowed the money for capital investment and still needs the borrowed funds for future capital investment, so we would wish to retain the money for investment in any case. It would severely deplete our recovery ability after the pandemic and resulting effects if we do not have access to these funds, which in turn will make it harder to attract students and staff to Sussex.

How significant is breach of financial covenants?

This was covered in depth in the webinar and you are encouraged to review this part of the recorded presentation and associated questions. It is always best to avoid breach of covenants since this gives the lenders contractual rights, which can be extensive, in order for them to protect their commercial interests. However, our lenders are long-term supporters and business partners of the University. They expect to have a long-term relationship and we update them regularly on our finances and prospects. It should be possible in the case of covenant breach to agree that lenders will allow a 'covenant adjustment' for a limited period where different ratios than those we have talked about may be permitted, as long the University has clear plans to restore its finances. Not surprisingly, they will expect the University to be acting to reach annual financial sustainability within a short period of time to demonstrate that it is in control of its finances. The University is not alone among higher education institutions (let alone the wider economy) that will potentially need to adjust its financial performance as a result of losses due to the Covid19 pandemic. The loan covenants are one indicator of financial health but not the only one. The difficult issue for the University is not the loan covenants per se but the potential huge losses of income. These threaten the University for the reasons covered in the webinar, and which we have discussed at length over the last year when explaining why the University needs to produce a surplus. Namely, that if we do not produce surpluses our ability to absorb future shocks and our investment capability is severely depleted. The current financial concern is therefore not just and not primarily the lenders, it is about an ongoing need for the University to be able to manage its finances on an annual basis by living within the means afforded by its income. Difficult judgements will need to be made about how long the income crisis will last, as well as how deep, so that we can make the best decisions in the circumstances. Council and our regulator OfS, as well as external stakeholders, will want to see that the University has strong plans to manage its finances and maintain the confidence of all stakeholders.

Webinar questions on borrowing

With the set gearing ratio, Sussex seems to already be at 1:2 borrowing limit (£180m:£360m). This seems to be the most onerous. Handing back some of the loan money will improve the borrowing ratio condition and help prepare us to rebound and absorb students when we come out of crisis and demographic dip. You say we need to be financially sustainable, but we also need to be sustainable in terms of staff capacity - surely staff capacity is the short-term priority?

The borrowing calculation in our loan agreements is calculated after adding back pension provisions and so we have more leeway than the question suggests. In reality, we have to manage maintaining both staff capacity and the condition of our estates and infrastructure. As we know we are crucially dependent on attracting students and staff, and the debate over the last 12 months has demonstrated clearly that the campus community recognises that the estate requires significant work. While we cannot do everything, the best solution will always be a balance between making sure we are an attractive location for staff and students, and making sure we have the best staff, in a combination which is academically and financially stable.

Notwithstanding the fact that we are currently at limit and can't borrow anymore, is it possible for universities to enter into borrowing agreements that cover short-term operational costs whilst interest rates are low?

Subject to the gearing covenant in our loan agreements, it is possible to further borrow funds. However, it is always important to understand how any loan would be repaid to avoid future difficulties in repayment. Council will decide whether we undertake any further borrowing. However, this will not take away the need to manage our finances within our means.

Has the university had legal advice on whether the requirements for surpluses can be suspended due to the pandemic?

There are no conditions in loan agreements to suspend the compliance with financial covenants - lenders want to be sure their funds are safe whatever the circumstances. However, lenders are of course aware of the exceptional conditions at present and will understand the reason why covenants may not be met in the short-term. Our relations with our investors are good and positive. However, given that their money is at risk in case of underperformance of borrowers over the long-term, lenders will expect us to plan to return to financial covenant compliance.

When was the private placement placed? I've heard it is a US creditor - is the £100m sum owed a dollar sum, or a Sterling sum? And if the latter is it hedged against devaluations?

The Private Placement was carried out in a bidding process in 2017 managed for the University by Lloyds Bank, with expert professional legal and financial advice. The funds came from four institutions, mainly US based but some with relationships managed from UK branches. The loan is denominated in sterling – managing currency risk is the lender's responsibility and is easily managed by them through capital markets.

Other questions received at the seminar or afterwards

We have included responses to queries we didn't have time to reply to at the webinar and a few questions which have been sent. Where subjects overlap, we have chosen the wording from one of the questions to respond to here.

Budgeting

In the webinars (as well as in a VC email to staff of 5 May), you mentioned the possibility of the University's income in 2020/21 being reduced by £38m as a result of a drop in international students, by £13m as a result of a drop in Home and EU students, and by £20m as a result of a drop in campus rents, giving a total of £71m. In response to a question, you said that these figures were only illustrative and that the base budget for 2020/21 will use less pessimistic forecasts. What forecasts for these three numbers and for the total reduction in income relative to pre-Covid-19 forecasts will the base budget use?

It would be inappropriate at this stage to comment on this since the budget will be reviewed by Strategic Performance and Resources Committee (SPRC) and approved by Council in early July. SPRC may suggest changes to the proposed budget and Council must be able to decide for itself the most appropriate assumptions. We expect that there will be news of the budget and assumptions later in July.

How will the University's budget 2020/21 be set?

Substantial work has been carried out already with individual budget holders both in Schools and Professional Services, and with the University Executive Group (UEG) to consider budget proposals for next year. SPRC (a senior committee of Council) carries out scrutiny on UEG's proposed budget, including whether any adjustments are required, before proposing the budget to Council. Council as our governing body is the committee which approves the University budget. Council will meet at the start of July and this meeting is the one at which the budget will be considered. I gave a view in the webinar as Director of Finance on how we might approach the budget, and mentioned a measured approach proportionate to the circumstances, to demonstrate its financial sustainability and which will require judgement based on emerging certainty of our income for the next academic year. But I would stress that this is all subject to Council approval. Council can be expected to give especially robust scrutiny of plans in the current context. It would not be appropriate to comment in more detail before Council has approved the budget. We expect to share more details of Council's approved financial plan for next year in July.

Clarification of webinar figures

When you talk about 'operating surplus' (e.g. achieving about £20m in 2018/19, a planned 'operating surplus' of £16m in 2019/20 (reduced to near to zero by Covid-19-related loses) and a targeted 'surplus' (we assume this again refers to 'operating surplus') of £12m in 2020/21), what do you refer to? Is this a figure which appears in our accounts?

The operating surplus is intended to reflect underlying performance and so excludes selected one-off items from our accounts, which could distort the view of how the University is performing on an ongoing basis. This is not an exact science and the figures do not appear as an identifiable single number in our accounts. Graphs in this series of webinars (and the series last year) show the key items excluded from the operating surplus. These, in my view, give a clearer and more consistent view of the University's underlying financial performance.

How may the 'net cash inflow from operating activities' (Financial Statements 2018/19 p. 28) be calculated from the 'operating surplus' as defined above? In particular what figures for 'net cash inflow from operating activities' correspond to operating surpluses of zero in 2019/20 and £25m in 2020/21?

Net cash inflow is covered in our financial statements as noted. Each cashflow statement starts from deficit or surplus for the year from the statement of comprehensive income. It reconciles the movement in surplus of deficit to the change in cash and cash equivalents (only) between the start and the end of the year. As 'operating surplus' does not appear in our accounts as a separate number, the adjustments which we have made in the graphs in the webinar would need to be reapplied to reconcile from operating surplus to deficit or surplus for the year. However, it is worth noting that many of the adjustments we make are for non-cash items and that the cash at the start and end of the year are, of course, always the actual balances held.

You said that a budget for the Voluntary Severance scheme has been agreed with Council. What is that budget?

Council has approved a maximum spend on Voluntary Severance. There is no target saving as we have agreed that the scheme is entirely voluntary on the part of staff. We think it would confuse staff to see that a budget has been set which could be misinterpreted as a target saving. After the scheme has closed, we intend to publish the costs of severance and expected savings.

You said the University had £109m in cash and cash equivalents and £117m in current investments, giving a total of £226m, at 31 July 2019. What are the figures cash and cash equivalents and for current investments at present (May 2020)?

The University does not publish these on an ongoing basis as it is important to go beyond the numbers and interpret them for stakeholders, including banks and lenders, since (as stated clearly in the webinar) cash balances at any one time always need interpretation for what commitments exist against those balances. Nevertheless, as will be clear from an expected breakeven in 2019/20 and low capital spend, our cash position is broadly similar to last year end.

You analysed the figure of £226m of cash, cash equivalents and investment as committed endowments, BSMS etc. (£10m), Capital commitments contracted but not incurred (£6m), Working capital (minimum of £50m, higher at some times of the year), Private placement loan for capital investment (£100m), which leaves around £60m. What purpose is the remainder of £60m presently earmarked for?

This is an approximate breakdown and will change throughout the year - principally affected by working capital, capital spend and operating surplus. The £60m not listed is dedicated to other purposes, such as capital works not contracted at 31 July 2020, and includes the fit out of the Student Centre. Any funds to which we have access and are not committed can act as a buffer to unexpected financial shocks, such as we have had this year, but strictly they are dedicated in our core plans as part of the cash which we have available to invest in the Estates and IT Masterplans. We noted in the webinar that the essential capital works, which the campus community has been asking for and which we know is critical to the student experience, have been prioritised to £300m of investment partly funded from the Private Placement, partly from future surpluses and partly from existing cash balances (including this £60m) generated by past surpluses.

Do you expect private partners, such as Balfour Beatty, to be reconsidering their future investment plans in the HE sector? What are the implications for the University?

The existing East Slope deal is fixed in a ring-fenced legal structure and so will continue to exist through the full term of the 50-year concession. Planning for West Slope continues at a minimal level and the University and Balfour Beatty achieved full planning permission for the development in May 2020. The timing of the future of formally committing and the main part of delivering this project is subject to operational and financial review at the end of this calendar year. There is no evidence at this stage that private partners, including Balfour Beatty, will change their attitude to working with the University. Universities are typically some of the first enterprises to emerge from periods of recession and demand for university projects, especially for strong and attractive universities like ourselves, will hopefully remain strong.

Other questions

What savings have been generated form the implementation of the Financial Review Guidelines to conserve cash? What do you expect to save in 2020/21?

We do not have a way of tracking spend which has not happened, or of distinguishing which savings are due to the guidelines and which would simply happen as a result of budget holders taking relevant action in the current situation. We estimate lost income, and new costs and losses in 2019/20 to be in the region of £19m. Against these losses, our estimate is that up to £9.7m of 2019/20 savings may have been generated since the start of the crisis, principally through some £7m of non-staff cost reductions such as stopping non-staff Strategic Development Fund spend, cutting estates works, reducing utilities costs, cutting travel, conferences, catering and so on; around £1.2 million is estimated to be saved through staff vacancies.

It would not be appropriate to comment on 2020/21 before the budget is approved, but the incremental savings will be lower since budgetary groups were already planning for reduced budgets through anticipating freezing vacancies, reducing consumable and equipment spend and so on.

Can you please clarify what the implications of unoccupied rooms in East Slope will be in light of university obligation to nominate 75% of rooms for the year?

The University is as yet unclear on whether it will be possible to occupy residences in full or in part. The University is only obliged to nominate and pay for 75% of the rooms during the construction phase so this is a short-term issue. We will, of course, seek to ensure that the East Slope rooms are full and that we maximise the utilisation of East Slope so that we can cover the obligations to the residential development partner. In the worst case we would be obliged to pay over rent for 75% of the rooms on which we did not receive rent from students. However, the issue of non-utilisation or low utilisation of student accommodation is also an issue on our own residences, where we will have costs of providing and maintaining accommodation that will not be met by rent if we cannot fully occupy the campus. Health and safety of students and staff is our key priority and we are working to make sure that we provide safe accommodation in line with government guidelines from the appropriate time.

Are the local pension deficits mentioned near the start part of the USS pension?

No. There are liabilities for the USS pension scheme which are calculated as the future recovery plan payments on our estimated future payroll. There are also liabilities for the USPAS scheme, which are represented by the full actuarial deficit on this scheme calculated according to accounting rules. Paying off the deficits on both schemes will protect the pensions for USS members and for USPAS members.

You said we haven't made any staff redundancies. There is a permanent Research Fellow in MPS who has been given redundancy notice. Does this mean his redundancy will be withdrawn?
I answered this question directly in response by email after the webinar and it’s not reasonable to answer this in principal as it is a personal matter for the individual concerned. At a general level under normal business, the University employs many people on, for example, fixed term research projects who, when the funding concludes, are technically made redundant and we cannot guarantee employment will be extended in these cases.

Over a decade, government policy has pushed universities to take on increasing levels of debt in order to finance the buildings and amenities necessary to attract a dwindling supply of students in a competitive market. The Covid-19 crisis severely disrupts this model, and the Vice Chancellor has said that not all UK universities will survive. Does this reveal that the underlying model is broken (both economically and morally), or can things return to "normal" once the existing crisis has passed?

This is a big question! Confining the answer to the financial matters, the key questions are how long the crisis goes on and how deep it goes. Even in the best scenarios it is likely that international student numbers and international fees will be less than they are currently. This is significant to UK universities because international tuition has been one of the largest sources of surplus to the sector, as shown consistently in TRAC data across the sector. If the flow of income from international students is seriously disrupted for some time this will have an impact on the ability of institutions to cross subsidise, research and teaching subjects which otherwise would be less financially sustainable. Institutions currently vary by the amount of international income which makes up their economy and they also vary in their current financial state.

Not separately answered and reason

How are the £350m 'reserves' made up, how much is made by loans, how much do these cost us and why can't we return them if they are not useable?
This was covered in the webinar, please watch the presentation.

Why can't we use all our reserves during this time of crisis?
This was covered in the webinar, please watch the presentation.

How much cash is available at the moment? The financial statements p27 show 'Cash and cash equivalents' £100 million (up from ~£20 million in 2018). How much of this cash has been spent or is committed of this amount?
This was covered in the webinar, please watch the presentation.

Is meeting lender covenants really a priority. Should we be using the reserves to buffer against the 1-year shock and seeking to free ourselves from the constraints of the loan contracts. Has Sussex asked to pay off PPL loans or asked loan holders for dispensation or asked government to take on loans?
This was covered in the webinars and other answers above.

If the requirement of lenders is driving our strategy - surely we need to pay off the loans because they are constraining our ability to run as a University with charitable status?
This was covered in the webinars and other answers above.

If the Private Placement was taken out for the building of the Life Sciences building, and this building is not going ahead, can the loan simply be repaid in full in order not to have to be bound by the requirement not to go into deficit?
This was covered in the webinar and other questions.

Can you please clarify what the £100m raised through private placement for Life Sciences building is being used for/where it is being held in light of the LS building plans being paused?

This is covered by other answers.

What are the significant stipulations in the legal agreement mentioned by the VC in relation to the private placement? What are the consequences for the university of not making a surplus in line with that required by the legal agreement?
This is covered by other answers.

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