HOUSE OF COMMONS LIBRARY

BRIEFING PAPER

Number 6206, 3 April 2017

HE in England from 2012: Funding and finance

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Summary

The Government raised the cap on tuition fees for new student to £9,000 in 2012/13 and cut most ongoing direct public funding for tuition in England. This shifted the balance of higher education funding further away from the state and further towards the individual who benefits. Students can take out publicly subsided student loans to pay these higher fees. There is uncertainty about the final size of this subsidy and the Government's estimate of it increased considerably after the reforms were first announced. Subsequent changes to loan terms and accounting methods are expected to reduce the size of this subsidy to an even greater degree. These calculations affect the size of any saving in public expenditure and the extent of the shift in costs from the state to the individual beneficiary.

This note looks at the impact of the 2012 reforms and subsequent announcements on public expenditure on higher education in England and on the funding available for higher education institutions in England. It builds on the analysis of funding in Changes to higher education funding and student support in England from 2012/13. That note summarises the Government's reforms and looks at the potential impact on graduates, universities and public spending. It looks in detail at a number of areas which are only touched on in this note, including, the possible impacts on graduate repayments by income decile, the earnings assumptions behind the loan repayments model and the effect of different average fee levels.

In his summer Budget 2015 the Chancellor announced the biggest changes to student finance since 2012:

- Maintenance grants will end for new students from 2016/17 and be replaced by loans.
- A consultation on freezing the student loan repayment threshold for five years
- Allowing universities offering 'high teaching quality' to increase fees in line with inflation from 2017
- A review of the discount rate applied to the accounting treatment of loans.

After consultation the Government decided to freeze the repayment threshold all post-2012 borrowers. The discount rate used for the public sector accounting treatment of loans will be reduced from 2.2% to 0.7%. These changes are expected to result in savings to current spending when grants are replaced and a substantial cut in the subsidy element of loans, largely due to the lower discount rate. This note summarises some evidence on the possible financial impact of these changes.

The note HE in England from 2012: Student numbers looks at how student numbers figured in the 2012 higher education reforms and subsequent announcements and summarises the evidence on applications from new students.

1. Background

The Independent Review of Higher Education Funding – the Browne Report[1]- was published in October 2010. It made recommendations on the future funding and organisation of the higher education sector and on student finance. The main recommendations directly connected to funding were:

- Remove the direct public funding for most undergraduate courses and retain a much smaller amount (around 20%) to contribute towards higher cost subjects.
- Remove the cap from tuition fees. Institutions would keep all the income from fees of up to £6,000, but at higher fee levels the additional income would be shared with the Government. The share going to the Government would increase with the fee level.
- Extend student loans to part-time students
- Increase the student loans repayment threshold for graduates from £15,000 to £21,000 and review the threshold regularly to keep it in line with earnings growth.
- Introduce a real interest rate on student loans for graduates earning above the repayment threshold equal to the Government's cost of borrowing (inflation plus 2.2%) and ensure no one repaying their loan sees its real value increase.
- Extend the write-off period of loans from 25 to 30 years
- Increase student numbers by 10% to remove excess demand

The report concluded that, with static number of students, the reforms would eventually cut core public spending on undergraduate study by around £1.8 billion or almost 30%, graduates would repay more (55% more with fees of £8,000) but additional repayments would come from higher earning graduates and institutions could see an increase in their income[2] with fees of around £7,000 or more (10% with fees of £8,000).[3]

The Government announced its plans for reform of higher education and student finance in November 2010.[4] These followed many of the recommendations set out in the Browne Report. The major differences with an impact on funding were:

- A cap on fees of £9,000, no levy on fees above this level, but obligations on the institution to spend more on access for disadvantaged students
- A real interest of 3% above inflation for graduates earning above £41,000 (in 2016) with a sliding scale rising from inflation only at £21,000
- Annual uprating of both thresholds in line with growth in average earnings[5]
- No growth in student number

The general arrangements for the fees and loan repayment remain much the same as for pre-2012 students–they can take out loans to cover fees, they do not need to be paid up front, and graduates start

1 Securing a sustainable future for higher education –An independent review of higher education funding & student finance
2 Income from these fees and teaching grants only
3 ibid. pp43-44
4 Reform for higher education and student finance, BIS (3 November 2010)
5 The initial proposal was for five-yearly upratings.

repay 9% of any income above the earnings threshold. Higher fees will mean average loans will increase. This increases the potential *duration* of loan repayments as monthly repayments depend on income and the level of the earnings threshold, not debt levels.

2. Public spending on higher education in England

There are four main elements of public spending on higher education – direct funding through the Higher Education Funding Council for England (HEFCE) which covers both teaching and research, student maintenance grants and student loans.

2.1 Comprehensive Spending Review 2010 and later spending rounds

The Comprehensive Spending Review 2010 (CSR) set out the parameters for public spending over the period 2011-12 to 2014-15. The Spending Round 2013 made some minor changes to existing plans and extended this to 2015-16. The Spending Review and Autumn Statement 2015 gave the first spending plans for the years 2016-17 to 2020-21.

The CSR settlement for the Department for Business Innovation and Skills (BIS) gave the total level of resources for higher education (excluding research) at the baseline year and at the end of this period. This was to fall from £7.1 billion in 2010-11 to £4.2 billion in 2014-15;[6] a cut of 41% in cash terms and 44% in real terms.[7] This spending covers funding for teaching via HEFCE, direct maintenance support and spending by BIS on access. It excludes direct funding for research which was added to funding for the Research Councils under the heading 'science and research funding'. This latter total would be kept constant in cash terms over the CSR period; a real terms cut of around 8%.[8]

The Spending Round 2013 announced a series of further savings from the higher education budget –the continued cuts in funding for teaching as the 2012 system applies to more students, freezing grants, requiring HEFCE to make additional savings and cutting access spending- but did not give a total figure.[9]

The headline CSR settlement figure excluded the cost of the subsidy element of student loans which at the time was expected to increase from £1.7 billion in 2010-11 to £3.3 billion in 2014-15.[10] Adding the higher education and loan cost elements together made total public funding for higher education (excluding research) in England £8.8 billion

6 BIS news release 20 October 2010, *The Department for Business Innovation and Skills Spending Review Settlement*
7 Adjusted using March 2015 GDP deflators and OBR projections.
8 ibid.
9 Spending Round 2013, HM Treasury
10 *Economic and fiscal outlook*, Office of Budget Responsibility November 2010). Supplementary table 1.10

in 2010-11 and £7.5 billion in 2014-15; a cash fall of 15% or a real cut of 22%. The CSR did not give separate figures on capital funding for higher education. The overall capital settlement for all BIS functions was planned to fall by a greater amount than resource spending.

More detail on spending has been published since the CSR, particularly around the subsidy element of student loans. Autumn Statement 2013 announced the cap on student numbers would be raised in 2014-15 and lifted in 2015-16 which will increase spending compared to what it would otherwise have been.

2.2 Autumn Statement 2013 announcement on student numbers

In the Autumn Statement 2013 the Chancellor announced that the cap on student numbers in England would be increased by 30,000 in 2014/15 and removed in 2015/16. It was estimated that this could mean an additional 60,000 students starting each year[11] described as "...young people ... who have the grades to enter higher education but cannot currently secure a place." [12] The annual cash cost of removing the cap on student numbers was estimated at £2.6 billion in 2018-19; £0.7 billion in maintenance grants and direct spending on teaching[13] and £1.9 billion on the full face-value of loans. The resource cost of this policy –which only included the subsidy element of the loans[14]- was expected to be around £1.4 billion per year in the medium term; just over half of this was the subsidy element of loans the rest was grants and teaching costs.

The first data on new students starting in 2014 was limited to full-time undergraduates. Taken on its own, this suggested that the increase in home and EU students at English institutions would be well below the 30,000 estimate used as the basis of the cost of the policy in this year. Data from the funding council put the increase at 10,000.[15] The same as the Office of Budget Responsibility had assumed for in 2014/15 (and similar increases in the following two years).[16]

The number of home and EU part-time entrants fell by around 1,300 (headcount) in 2014/15, continuing a downward trend that had started before 2012.

There was a continuation in these trends in 2015/16 with an increase of 16,000 in full-time and a fall of 5,000 in part-time undergraduates. Early data for 2016/17 shows a further rise of 4,000 full-time and a drop of 9,000 part-time undergraduates.[17] Lifting, then removing the

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11 The Government assumes £345,000 full-time entrants in 2013/14 (HC Deb 24 February 2014 c156-7W

12 *Autumn Statement 2013*, HM Treasury

13 Includes the cost of the knock on-impact of this spending increase on Treasury grant to Scotland, Wales and Northern Ireland ('Barnet consequentials')

14 The proportion of their face value which is not expected to be repaid, in present value terms.

15 *Higher education in England 2015. Key Facts*, HEFCE (July 2015)

16 *Economic and fiscal outlook. March 2015*, OBR

17 *Higher Education in England*, HEFCE

cap on student numbers has not yet resulted in the scale of increases in students that was initially estimated.

Entrants to taught postgraduate courses changed little up to 2015/16, but in 2016/17 increased by 22% for full-time and 9% for part-time courses. The funding council attributes this to the introduction of postgraduate loans.[18]

The Autumn Statement explained that the additional outlay of *loans* over the period to 2018/19 would be more than covered by sales of pre-2012 income-contingent loans.[19] It was estimated that gross proceeds from these sales over the five years from 2015-16 will be in the range of £10-15 billion, with a central estimate of £12 billion.[20] Sales of pre-2012 loans cannot go on indefinitely and even if it were assumed that pre-2012 loan sales continued (as far as possible) it is highly likely that the cumulative proceeds from loan sales would be less than the cumulative cost of lifting the cap within a decade.[21] If these costs still had to be met through loan sales at that point then sell offs would need to move to the post-2012 loan book.

The Institute for Fiscal Studies made the following comments after the Autumn Statement:[22]

> …in his speech the Chancellor claimed that the additional cost of student loans arising from lifting the cap on the number of students in higher education would be "financed by selling the old student loan book". This may work in the near-term fiscal numbers, but economically it makes little sense. Selling the loan book will be broadly fiscally neutral in the long run, bringing in more money now at the expense of less money later on. Lifting the cap on numbers will cost money every year.

The Office for Budget Responsibility (OBR) made the same point in their long-term fiscal projections. These conclude that so long as these loans are sold at a 'fair' value the expected return (on these assets) to the Government at the point of sale would be zero. In other words the sale price is equal to the present value of the lost future repayments. Selling loans at a fair price would only affect the *flow* of receipts not their present value.[23]

In July 2014 the Secretary of State was reported to have ruled out any sale of these loans (in this Parliament) because recent evidence

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18 Ibid.

19 The Summer Budget 2015 added that the savings linked to the changes to student finance it outlined were needed to put the expansion of higher education on a sustainable footing.

20 *Autumn Statement 2013*, HM Treasury

21 The cost of the policies is the sum of the cash value of new loans and direct spending on additional students, plus the value of lost repayments from loans which are sold. This calculation assumes that the gross proceeds estimates in the Autumn Statement are met and further tranches are sold with gross proceeds of £2.5 billion per year after 2019-20. Cumulative gross costs are larger than cumulative gross proceeds by 2023-24 with an assumed 40% write down on all loan sales. Changes in the write-down rate have a large impact on the total proceeds.

22 Autumn Statement 2013: Introductory Remarks, IFS

23 Fiscal Sustainability Report – July 2014, OBR

suggested there was "…no longer any public benefit…" to the sales.[24] The Government subsequently said that the expansion of student numbers has been agreed with the Treasury and "Student numbers are not contingent on the sale…"[25] This was restated in the Government's response to the Business, Innovation and Skills Committee report on student loans which also added that the expansion was agreed with the Treasury and "fully funded".[26]

The Autumn Statement 2016 said the Government intends to launch the first sale in early 2017 "…subject to market conditions"[27]. The OBR's Economic and Fiscal Outlook, published alongside the Autumn Statement, said they continue to expect that around £12 billion will be raised through these loan sales. They have changed the forecast timings of these proceeds. They judge that there is a less than 50% change the first sale will happen in 2016-17 and now assume the first and second sales can both take place in 2017-18

2.3 Summer Budget 2015 and Spending Review/Autumn Statement 2015

In his Summer Budget 2015 the Chancellor announced that maintenance grants would end for new students from 2016/17 and be replaced by loans. He also announced consultations on freezing the repayment threshold for five years, allowing some universities to increase fees in line with inflation from 2017 and a review of the discount rate applied to the accounting treatment of loans.[28] These are the biggest changes to student finance since 2012.

The Government published a consultation on freezing the loan repayment threshold in July 2015. This set out two options for change:

- Option 1 (preferred): Freeze the threshold at £21,000 from April 2016 for all existing and new borrowers for five years. Reviews the threshold from April 2021
- Option 2: Freeze the threshold for new borrowers only for five years from April 2020

The consultation estimated that option 1 would generate £3.2 billion (current/discounted values) in additional graduate repayments from existing borrowers. On top of this one-off amount there would be an additional £0.9 billion for each £15 billion of loans to new students.[29] Under Option 2 only the amount for new students (put at £1.0 billion per £15 billion of loans) would apply.[30]

[24] Student loans sell-off abandonment raises tension in cabinet, The Guardian 20 July 2014
[25] PQ HL1512 [on Higher and further education: Admissions], 11 August 2014
[26] Student Loans: Government Response to the Committee's Third Report of Session 2014-15, BIS Select Committee second special report of session 2014-15
[27] *Autumn Statement 2016*, HM Treasury. para 1.66
[28] Summer Budget 2015, HM Treasury
[29] This volume of loans is approximately the amount that might be lent to each cohort of new students.
[30] *Consultation on freezing the student loan repayment threshold*, BIS (July 2015)

The Government published its response to the consultation in November 2015.[31] It accepted that most responses did not support freezing the threshold, but said it would implement its preferred option –freeze the repayment threshold for all post-2012 borrowers at £21,000 until at least April 2021. An equality analysis was produced alongside the consultation response.[32] This looked at the impact on different types of 'protected characteristics' such as age, sex, disability and ethnicity.

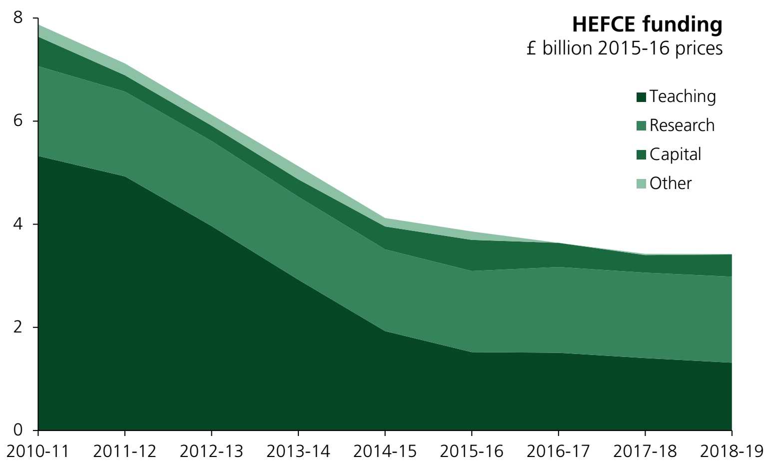
The Spending Review and Autumn Statement 2015 made some headline announcements about funding paid through the funding council, the extension of maintenance loans to part-time students and new loans for Master's degrees. It also announced that the discount rate applied to loans would be reduced to 0.7% and set the spending totals for the Department for Business, Innovation and Skills which will eventually feedthrough to annual funding allocations for higher education.

The notes on maintenance support and loans look at the impact of these changes on students/graduates. Some estimates of the impact on public spending are included in the next sections which look at each main element in turn.

2.4 Direct funding through the funding council

The Secretary of State writes to HEFCE around the turn of each year to set out funding, priorities, student numbers and related matters for the following financial year. Occasionally these letters cover more than one year and sometimes revised versions are published. The most recent full funding letter was published at the end of February 2017. It covered funding in 2017-18 and gave indicative allocations for the following year. All these funding letters from the mid-1990s onwards can be found at: http://www.hefce.ac.uk/funding/annallocns/Archive/

The following table gives details of HEFCE funding and estimated fee loans from the latest funding letters. Changes to the main elements in real terms are illustrated opposite.



31 Freezing the student loan repayment threshold Government response to the consultation on freezing the student loan repayment threshold, BIS (November 2015)

32 Freezing the student loan repayment threshold. Equality analysis, BIS (November 2015)

Funding for the HE sector in England through HEFCE and tuition fee loans, £ million cash

	2011-12 Revised allocation	2012-13 Revised allocation	2013-14 Revised allocation	2014-15 Revised allocation	2015-16 Initial	2015-16 Revised	2016-17 Budget	2017-18 Budget	2018-19 Indicative
Recurrent grants									
Teaching	4,645	3,815	2,861	1,915	1,671	1,521	1,539	1,457	1,386
Research	1,549	1,587	1,573	1,573	1,573	1,573	1,695	1,716	1,755
Total	**6,194**	**5,402**	**4,434**	**3,488**	**3,244**	**3,094**	**3,234**	**3,173**	**3,141**
Higher Education Innovation Funding	113	119	113	113	113	113	0	0	0
Additional funding									
Voluntary matched giving	63	0	0	0	0	0	0	0	0
Access to Learning Fund	40	37	37	0	0	0	0	0	0
National Scholarship Programme	0	50	100	50	0	0	0	0	0
Postgraduate provision	0	0	0	0	50	50	0	0	0
Capital funding									
Teaching	95	90	79	154	300	300	140	150	150
Research	204	195	251	286	303	303	338	203	303
Total	**299**	**286**	**330**	**440**	**603**	**603**	**478**	**353**	**453**
All funding for institutions via HEF(	**6,709**	**5,893**	**5,014**	**4,091**	**4,010**	**3,860**	**3,712**	**3,552**	**3,604**
Estimated fee income from home/EU students subject to regulated fees	2,600	4,200	5,600	7,000	8,100	8,000	8,600	9,000	..
Total funding for institutions via HEFCE and regulated fee income	**9,309**	**10,093**	**10,614**	**11,100**	**12,100**	**11,860**	**12,300**	**12,500**	**..**

Sources: Higher education funding for 2017-18, and earlier, BIS/HEFCE; Reductions to HEFCE teaching grant for 2014-15 and 2015-16 academic years, BIS

Teaching

The 2012-13 funding letter confirmed the intention to cut all core funding for the teaching of lower cost courses[33] and to only fund the *additional* costs of more expensive lab-based courses, medicine, dentistry and veterinary science at undergraduate and postgraduate levels. The letter also spelled out that HEFCE's funding for teaching needs to meet Government priorities including to protect 'strategically important and vulnerable' subjects, improve access/widen participation and cover the additional costs of specialist institutions.

The 2014-15 letter made cuts in recurrent teaching funding over and above those announced in the indicative totals a year earlier. The 2014-15 total was £45 million less than the indicative figure even after extra funding provided at the Autumn Statement for additional students and 'mainstreaming' of government funding for access and student success into the teaching total are taken into account. £20 million was added to the teaching capital total for 2014-15 and was almost doubled in 2015-16.

The table above shows that direct recurrent funding for teaching fell by £830 million or 20% in real terms in 2012-13. This was the first year that included some students under the 2012 funding arrangements. This funding is in financial years, which precede academic years, so in effect it only includes the reduced funding for just over one half of one year of students under the new arrangements. Further cuts of around £950 million were made in 2013-14 and 2014-15 and £250 million in 2015-16.

33 Current band C and D courses frequently lumped together as 'arts and humanities'. HEFCE is consulting on splitting the current C band into C1 courses, which will receive a small amount of mainstream funding, and C2 courses which will receive none.

The initial 2015-16 total was 66% below the below the 2011-12 level in real terms. The subsequent cuts meant it was around 69% below the 2011-12 total. In 2015-16 almost all full-time undergraduates came under the post-2012 funding arrangements. This means that later cuts in funding for teaching have been more modest. The 2018-19 indicative total was 73% below the 2011-12 figure in real terms.

The impact on what HEFCE plans to distribute up to academic year 2017/18 is given later in this note.

The figures in this and other sections include changes for part-time students from 2012. At the time the reforms were announced the Government estimated that savings from removing direct funding and fee/course grants would be greater than the additional costs of providing fee loans. The net saving on part-time funding in 2014-15 was estimated at £150 million.[34]

Spending Review 2015 announced that the teaching grant would be cut by £120 million in cash terms by 2019-20, but within this reduced total funding for high cost subjects will be protected in real terms. The student opportunity fund, which supports institutions in their efforts to widen access, will be cut by "…up to half."[35]

Research

The 2012 changes in university funding directly affect teaching rather than research. Since the CSR funding for research paid to institutions through HEFCE has been included in public spending figures with other science funding, rather than other higher education funding. Plans were set out for each year to 2014-15 soon after the CSR was published. The earlier table shows that recurrent funding for research will broadly keep its cash value up to 2014-15. The 2013 Spending Round kept the total resource (recurrent) science budget for 2015-16, which included funding for Research Councils and other areas, at the same cash level as earlier years. Total capital funding for science will increase.[36] The 2015-16 total in the table above is still below the 2010-11 allocation by around 14% in real terms.

Spending Review 2015 announced that total science funding, which includes HEFCE research grant and funding paid through the Research Councils, will be protected in real terms to the end of the current Parliament.[37]

Research funding paid to higher education institutions through HEFCE funds the research capacity and infrastructure –such as the salaries of permanent academic staff, premises, libraries etc- while the Research Councils fund specific research projects.

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34 Interim impact assessment –Urgent reforms to higher education funding and student finance, BIS (26 November 2010). Table 9

35 *Department for Business, Innovation and Skills' settlement at the Spending Review 2015*, 25 November 2015

36 Spending Round 2013, HM Treasury

37 *Department for Business, Innovation and Skills' settlement at the Spending Review 2015*, 25 November 2015

Other

The 2012-13 funding letter highlighted the 'significant and increasing pressures' on BIS budgets. It announced the creation of a £62 million 'unallocated provision' to meet any unforeseen pressures on the Department's higher education budget. This has been created by cutting the Voluntary Matched Giving fund in 2012-13 from its earlier indicative level of £52 million to zero and by cutting the Access to Learning Fund by £10 million (compared to the indicative level). The funding letter restated earlier instructions to HEFCE about recouping funding from institutions that over recruit students in 2012 and again warned of the prospect of cutting HEFCE's grant in 2012-13 or future years if over recruitment results in higher student support costs or causes other pressures on BIS budgets.[38] The note HE in England from 2012: Student numbers looks in more detail at the changes to student number control and financial implications of over recruitment.

The 2013-14 funding letter made some changes to the treatment of student numbers in response to recruitment in 2012/13 which was down, particularly among those liable for higher fees.[39] These included greater flexibility in how HEFCE operates the 'core and margin' model of student number control and giving institutions a 3% over-recruitment 'buffer zone' before penalties are imposed.

The 2014-15 letter incorporated the cut to the National Scholarship Programme announced in the Spending Round 2013, ended separate funding for the Access to Learning Fund (which provided hardship payments), directed HEFCE to combine this with its student opportunity funding[40] for institutions and also included the implications of the Autumn Statement 2013 for funding through HEFCE. The 2015-16 letter confirmed earlier allocations.

2.5 Student loans

There are two types of student loans –fees and maintenance. Full-time home and EU students on qualifying courses can take out a loan to cover the tuition fees for their course. From 2012 new part-time students on courses with an intensity of 25% or greater became eligible for loans. From 2016-17 postgraduates could apply for fee loans of up to £10,000 have loans of up to £10,000.

Maintenance loans are available to home students only. The amount someone can take out as a maintenance loan depends on their household income, where they live and where they study. From 2016/17 maintenance loans will entirely replace grants. The value of student maintenance support gives more details and Student loan statistics gives more background about the system.

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38 ibid.

39 The note Entrants to Higher Education looks in detail at 2012 recruitment

40 The student opportunity stream is meant to support institutions' efforts to widen participation and allow then to meet the higher costs of supporting disadvantaged and under-represented students through their courses

Subsidy elements of loans

The earlier table gave BIS estimates of the face value of fee loans to English students and EU students studying at English institutions. Only part of the face value of fee and maintenance loans paid out in any one year counts as public expenditure. This is what the Government expects the subsidy element to be and is viewed as the permanent costs of the loan to the taxpayer. This system is known as resource accounting and budgeting (RAB) or accruals accounting and has been in place in the public sector for more than a decade. The subsidy element is calculated as the face value of loans made in any one year less the discounted or present value of future repayments. This can be thought of as the amount of money lent to students that the Government does not expect to get back. It is frequently expressed as a proportion of the value of loans, the so-called RAB charge.

There are two main parts to the subsidy in student loans: i) their interest rate and ii) their write off terms. The cost arises in i) where interest rates are set below the Government's cost of borrowing, they represent a cost to Government even if they are repaid in full. This cost increases the longer it takes to repay the loan. Costs arise in ii) for all elements of write-off. As loan repayments depend on income some or all of a borrower's debt may be written off at the end of the loan period (30 years for new starters from 2012) –write off for low lifetime earnings. Debts will also be written off for long term disability or death. The introduction of a real interest rate and higher repayment thresholds will mean the subsidy from 2012 will be shifted away from the interest rate and towards write off (for low lifetime earnings).

Estimates of the resource costs of loans

The Government made estimates of the percentage RAB rate on new loans from 2012 when it published proposals for changes to funding. These are discussed in some detail in [Changes to higher education funding and student support in England from 2012/13](). The estimated RAB rate on new loans of around 30% has since been increased to 'around 35%' [41] then to 35%-40%[42], revised upwards again to 'around 40%'[43] and most recently to 'around 45%'.[44] These increases have been largely due to changes in economic forecasts, particularly on earnings.[45] These less optimistic forecast reduce the expected cash value of repayments and or delay when they will be made. Other factors behind the increase in the RAB rate include the higher than expected level of average tuition fee loans, a change to the timing of repayment threshold uprating, lower assumed repayments from the extra students

41 HC Deb 4 July 2013 c775-6W
42 HC Deb 9 December 2013 c5W
43 HC Deb 19 December 2013 c780W
44 HC Deb 20 March 2014 c706W
45 The OBR links lower earnings growth to "…much weaker-than-expected growth in productivity." They also note that the data now used for modelling repayments, including that from the Student Loans Company, have widened the modelled distribution of earnings among graduates. This wider distribution cuts expected repayments, even if average earnings remain unchanged. [Fiscal Sustainability Report – July 2014](), OBR

who start higher education because the numbers cap is lifted[46] and improvements to the Governments loan repayment model which is used to forecast repayments and hence calculate the resource costs of loans.[47]

Loan repayment models

BIS estimates of the RAB cost of student loans are calculated using a student loan repayment model. This makes long term forecasts of repayments for individual borrowers and is highly complex. There is a substantial amount of uncertainty about future repayment levels which are connected in large part to earnings growth forecasts. The 2013-14 model assumes short-term average earnings growth in line with Office of Budget Responsibility forecasts[48] and long-term growth of 4.4%.[49] The BIS accounts state that there is 'significant' potential for actual repayments to vary from forecast ones in the short and long-term. As examples the accounts state that if real earnings growth were 0.5 percentage points lower than assumed each year the value of the loans held would be £1.2 billion lower and if graduate income profiles[50] were 5% lower than assume each year the value of loans held would also be £1.2 billion lower. In both cases the relationship between the value of loans issued and the assumed indicator are not linear and further reductions would have an even greater additional impact.[51]

A substantial degree of uncertainty remains despite improvements to the model used to forecast repayments. In November 2013 the National Audit Office published a report on how BIS manages and forecasts repayments. This pointed out a number of weaknesses in the model used at the time. A new model was introduced in 2013-14 and in his report on the accounted the Comptroller and Auditor General concluded that it could forecast repayments with more precision and is "..substantially more accurate…" in its short term forecasts[52]. However, the expected growth in the scale of loans could magnify what are currently small differences between forecast and actual repayments and the model would need to "..keep pace…" with these matters.[53]

A simplified version of the model used to produce estimates for their accounts was made public to inform debate around the changes to funding in 2012. There was much debate around the assumptions used for this model. Some commentators said the earnings assumptions over optimistic and the actual level of public spending would be above the BIS estimates –conclusions the recent increases in the RAB charge

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46 HC Deb 10 December 2013 c130W
47 These are summarised in the National Audit Office report Student loan repayments
48 The latest online (simplified) model assumes growth in the cash value of earnings of 3.2% in 2014, 3.8% to 3.9% in 2015 to 2019, increasing to 4.1% in 2021
49 It is important to recognise that these are not expected annual increases in salaries of individual graduates over their career, but uprating factors for the assumed income profiles which themselves generally show rapid increases in early career earnings
50 These are actual lifetime earnings profiles for modelled graduates which give income in each year post graduation. They are affected by assumptions about starting salaries, early career income growth, employment rates etc.
51 Annual report and accounts 2013-14, BIS
52 Based on retrospective testing against historic repayments
53 Annual report and accounts 2013-14, BIS

estimates seem to support. An updated version of the publicly available model was made available in January 2014. This calculated an overall RAB rate of 35% for standard assumptions of average loans, some way below the estimated rate at the time. This model was revised and updated in June 2014 and in July 2015. These version calculated the overall RAB at around 45% and 44% respectively for standard assumptions of average loans. These were both in line with the official estimates at the time.

Changes to higher education funding and student support in England from 2012/13 looks at the original model ready reckoner in more detail.[54] That note also looks at the implications for public spending of fee levels that are different from the Government's planning assumption. All the BIS estimates assumed an average tuition fee loan of £7,500 for new students from 2012. This is below the estimate (£8,123) of the average *fee* after deductions which was derived by the access regulator from institutions' access agreements. This is expected to increase further in each year to 2015/16 despite the freeze on the fee cap at £9,000. The increase is due to a combination of increases in headline fee levels (for those charging below £9,000) and a reduction in fee waivers. The provisional estimated fee level in 2015/16 is £8,830 or £8,761 after waivers.[55] A larger average fee loan increases the Government's cash outlay on loans and increases the percentage RAB charge by a small amount. If this increase were directly reflected in average *total* student loans then the modelled RAB rate could increase to the high 40 percents. The Browne proposal for a levy on additional fee income above £6,000 would have meant that higher fees above this level had little or no impact on public spending.

Summer budget 2015 announced that for new students from 2016/17 loans would entirely replace grants and the total maintenance support available would be increased for students from lower and middle income households

Summer Budget 2015 and the RAB charge

The different elements of the changes to student finance announced in the Summer Budget all have an impact on student loan outlays and the RAB rate/charge. Changes to maintenance support will increase the cash amount loaned. This on its own would increase the RAB rate, but as the increase will be largely for those from lower income backgrounds –which is linked to some extent to lifetime earnings- the increase will be larger still. Freezing the repayment threshold will increase repayments and hence cut the RAB rate. Allowing some institutions to charge above £9,000 will increase tuition fee loan amounts and increase the RAB rate slightly. Reviewing the discount rate applied to loans is meant to bring this in line with the Government's long-term cost of borrowing. It would have no impact on loan outlays or the cash value of repayments and hence no impact on borrowers. It would be an accounting change that

[54] The note referred to is no longer being updated. More recent reports looking at this issue include: The cost of the Government's reforms of the financing of higher education, HEPI 2012; False Accounting? Why the government's Higher Education reforms don't add up, intergenerational foundation (May 2012); Barr, Nicholas (2012) The Higher Education White Paper: the good, the bad, the unspeakable - and the next White Paper. Social policy & administration, 46 (5). pp. 483-508. ISSN 0144-5596

[55] Access agreements for 2015-16: key statistics and analysis, Offa

potentially could cut the RAB rate by a substantial amount and reduce the value of the RAB charge.

What is the combined impact of all these changes? The IFS made some assumptions about the (then) unknown aspects of this package and applied them to its own repayment model.[56] It estimated that the combined impact of changes to maintenance, the fee cap and repayment threshold would be to cut their estimate RAB rate from 39% to 36% and *increase* the RAB charge per cohort from £5.8 billion to £6.3 billion in 2016 prices. More money would be loaned to students and a greater proportion would be repaid by graduates. There would be a net saving to the public sector after the cut in grants is included of around £1.4 billion (17%). They estimated that using a discount rate of 1.1%[57] rather than the current 2.2% could cut the RAB rate to around 22% and cut the RAB charge by around £2.5 billion. This 'dramatic' change is described by the authors as "…essentially and accounting 'trick'".

The Government's estimates of the savings from freezing the repayment threshold from 2016 were set out earlier; £3.2 billion additional repayments from existing borrowers plus £0.9 billion for each £15 billion of loans to new students. It did not include any estimate of the combined savings from the Summer 2015 'package' in Spending Review 2015, but a subsequent written answer estimated that the RAB charge would be reduced to **20-25%**.[58]

This new, much reduced, RAB rate is broadly that given by the latest simplified version of the Government's loan model with appropriate changes to loan amounts, thresholds and the discount rate. The rate is only cut to around 40% if the change in the discount rate is not included.[59] It should be noted that the model does not take account of the differential increase in maintenance loans by household income and the (partial) link to lifetime earnings.

The Office for Budget Responsibility has forecast that the total value of new loans in England will increase from £12.0 billion in 2015-16 to £20.4 billion in 2021-22.[60] This is driven by replacing grants with loans, but also by maintenance loans for part-time students, fee loans for Master's degrees and replacing nursing bursaries with loans.[62]

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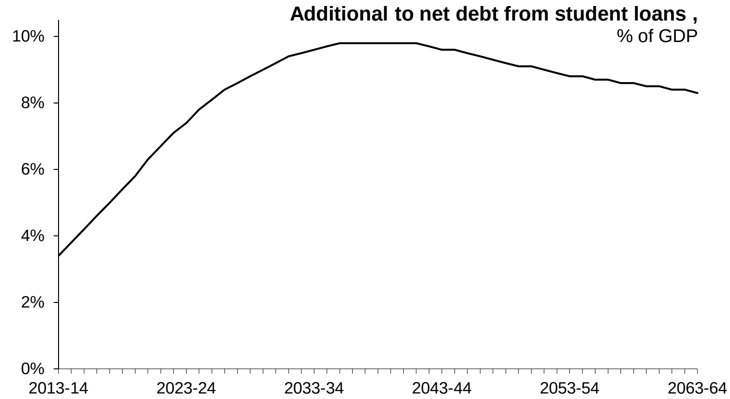
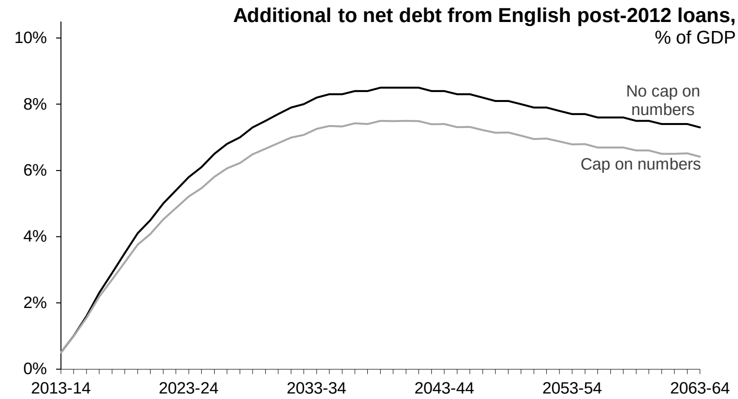
56 *Analysis of the higher education funding reforms announced in Summer Budget 2015*, IFS (July 2015)
57 The actual rate to be applied will be 0.7%
58 PQ HL 5098 [on Mature students: Loans] 18 January 2016
59 *Student loan repayment model*, BIS July 2015 and House of Commons Library estimates.
60 *Economic and fiscal outlook – November 2015*, OBR (Supplementary table 2.47)
61 Economic and fiscal outlook – March 2017, OBR (table 2.49)
62 ibid and *Spending Review and Autumn Statement 2015*, HM Treasury (Table 3.2)

Impact of loans on the national debt



Source: Fiscal Stability Report 2014, OBR



Source: Fiscal Stability Report 2014, OBR

The Office of Budget Responsibility has looked the impact of the 2012 reforms on the public finances using a combination of BIS modelling and its own estimates.[63] This focussed on cash flows (lending and repayments) and the impact on public debt, not the subsidy element. Their most recent long-term fiscal forecasts included an assessment of the impact of lifting the cap on student numbers on debt, loan sales, revisions to modelling and their assumptions about graduate earnings. It was produced before the Summer Budget 2015 changes to student finance were announced. The central projections for all (UK) loans are illustrated in the first chart opposite. The (cumulative) addition to debt increases rapidly from 3.4% of GDP before peaking at almost 10% in the mid-2030s. This would be equivalent to around £450 billion in 2013-14 prices.

This increase is almost all driven by post-2012 loans in England. This is illustrated in the second chart opposite which only includes these loans. It also illustrates the impact of removing the cap on student numbers from 2015-16. Projections made over such a long period of time are always highly sensitive to their assumptions. The figures presented here are central estimates only. So, for instance, the projections assume fees (and hence fee loans) increase in line with earnings each year, but if this is changes to uprating with inflation the peak rate is lower by around 1% of GDP and the early 2060s rate by around 3.3% of GDP.

The most recent OBR projections show that additions to national debt from loans peaking at 11.1% in the late 2030s.[64]

2.6 Student support

Spending on student maintenance grants was expected to increase from £1.3 billion in 2011-12 to £1.6 billion in 2014-15[65] although this forecast was made before the announcement on increases in student numbers. The additional students are expected to be more likely (than 'existing' students) to receive a grant and to repay a smaller proportion of their loans.[66] The Government has estimated that abolishing grants

63 See for instance Box 4.3 from the November 2010 *Economic and Fiscal Outlook*, Box 3.2 from their July 2011 *Fiscal Stability Report* or Student loans and the financial transactions forecast - Economic and fiscal outlook November 2011
64 Economic and fiscal outlook – March 2017, OBR
65 HC Deb 26 February 2013 C298WA
66 HC Deb 10 December 2013 c130W

and replacing them with loans for new students from 2016 could save £2.5 billion (cumulatively) by 2020-21.[67]

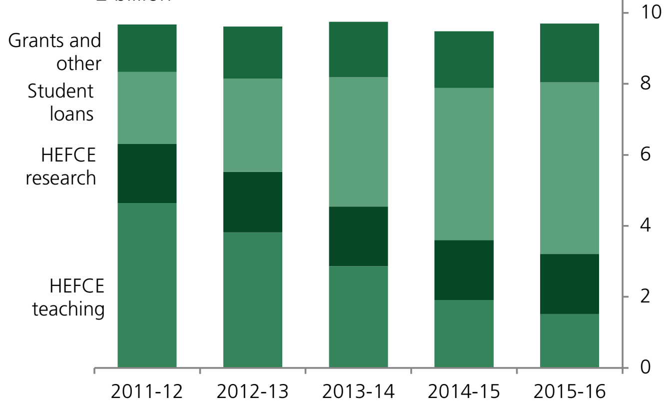
The Government announced the creation of National Scholarship Programme at the time of other proposed changes to higher education funding. This was central government support aimed at disadvantaged students attending institutions with fees of over £6,000. The institutions themselves were expected to at least match this funding. BIS spending under this heading is given in the earlier table. It was expected to increase to £150 million in 2014-15.[68] The Spending Round 2013 announced that the value of the government contribution to the NSP would be cut to £50 million in 2015-16 and it would be refocused on postgraduate students only.[69]

2.7 Overall spending

Up to 2015-16

The Government has yet published complete plans for all areas of higher education spending up to 2015-16. Bringing together the earlier information gives an idea of the change in the share of each of the main elements of public spending and how the total might change. Given the earlier upward shifts in the RAB rate for post-2012 student and the lack of information on revisions to the rate for pre-2012 students, the loan totals, and hence overall spending levels, are tentative. This is illustrated opposite.

BIS planned spending on higher education
£ billion

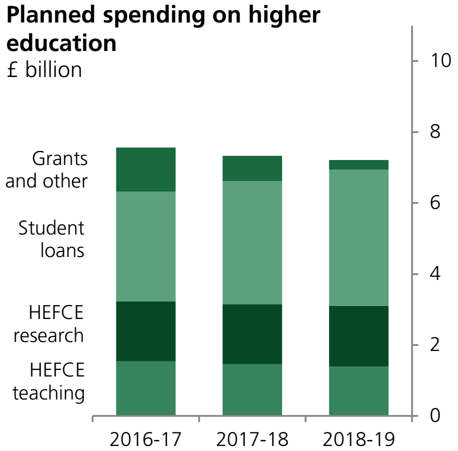


The shift in expenditure from direct funding for teaching to student loans is clear. Overall spending on this basis changes little in cash terms over the period covered here as higher loan RAB charges outweigh cuts in funding for teaching. Real 2015-16 spending is slightly less than 2011-12. These figures exclude some smaller areas of spending, but include the estimated impact of lifting the cap on student numbers, although the full impact of this will not be felt until towards the end of this decade.

Up to 2018-19

Other than grants to HEFCE there is even less published spending data up to 2018-19. The chart opposite gives some even more tentative estimates for this period. These use the new lower RAB rate –the mid-point of the 20-25% range- while the earlier chart users the previous estimate of 40%. As much of this is an accounting change only the two charts are not directly comparable. The main pattern over these years is the shift from (maintenance) grant to loans). After 2018-19 we would expect

Planned spending on higher education
£ billion



67 Summer Budget 2015, HM Treasury
68 See Offa press release 2 December 2011, [OFFA announces decisions on revised 2012-13 access agreements] for more detail of NSP allocations.
69 [Spending Round 2013], HM Treasury

no major change in the real value of these figures without any further policy changes, RAB charge revisions or unexpected patterns in student numbers

Funding per student

BIS had a performance indicator on levels of funding per student. This was updated annually, but has not been published since June 2014. The latest version can be found alongside other BIS performance indicators. This shows that total spending fell in cash terms in 2011-12, 2012-13 and 2013-14, but falls in the number of full-time equivalent students meant that estimated cash spending per student went from £6,130 in 2010-11 to £6,280 in 2013-14. Spending per student fell by around 8% in real terms over this period.[70] Clearly these figures do not yet include the full impact of the 2012 reforms.

3. Funding for institutions from HEFCE

3.1 2012/13

Initial allocations for individual institutions for 2012/13 were announced at the end of March 2012 and firmed up in July. They give a breakdown of funding and student number controls for all institutions for academic year 2012/13.

Compared to recurrent funding in 2011/12 all but three of the 129 higher education institutions saw a fall in provisional funding and this was by more than 20% at 74 of them. Cuts tended to be smaller at universities who receive more income for research including Oxford (-5%), Cambridge (-4%), Imperial (-3%) and Kings (-6%).[71]

Funding totals are subject to revision when more is known about actual student numbers. The 2012 reforms mean revisions are expected to be larger than in previous years. The first stage of revision came in March 2013 with adjusted allocations which reflected actual in-year student numbers. Most higher education institutions saw their initial allocations adjusted by less than 2% and around one in six has adjustments of more than 5% (plus or minus).[72] In October 2013 these tables were revised. Final allocations were confirmed in March 2014.

Student number controls for 2012/13 can also be compared to those for 2011/12. The implementation of the 'core and margin' model and the reduction in the total limit meant that totals given for individual institutions varied to a much greater extent than in the past. 34 of 129 higher education institutions were shown to have a limit more than 10% below their 2011/12 total. 22 were shown to have an increase; most of these are below 5%. The largest increases among larger

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70 *Funding per student in higher education –BIS Performance Indicators*, BIS (June 2014)

71 *Allocations of recurrent funding for 2012-13 (July)- Summary tables*, HEFCE (July 2012). Table 2

72 *Recurrent grants for 2012-13 Adjusted allocations*, HEFCE (March 2013)

institutions were for Oxford (14%, Cambridge (13%) and LSE (9%). Overall higher education institutions were expected to lose around 19,500 places;[73] a cut of 5.6%. Further education colleges gained additional places through the allocation of the 'flexible margin' for lower cost courses. Their net increase was 10,900 places; an increase of 48%.[74] HEFCE is due to publish analysis of the impact of the new funding arrangements on 2012/13 student numbers in March 2013.

The student number controls calculated by HEFCE include an estimate for each institution of the number of students who were no longer subject to student number controls. These are the 'AAB+' and medicine and dentistry students. HEFCE has apportioned them to institutions based on 2011/12 student numbers uprated for the expected growth in 2012/13. This means that their totals are not, strictly speaking, limits on recruitment for each institution. It also explains why higher education institutions with high proportions of 'AAB+' and medicine and dentistry students were shown as having the highest increases in their totals. More importantly it means that as institutions would be able to compete for these students with no restriction on their recruitment; their actual number of new entrants in 2012 *could* be substantially different from the totals given in this document.

In February 2013 it said that full-time undergraduate entrants in 2012/13 were around 28,000 below Government assumptions. This was in large part to changes in deferred entry in 2011 which is looked at in more detail in HE in England from 2012: Student numbers. They added that there were also 'modest' reductions in taught postgraduate entrants and a 'very significant' reduction in part-time undergraduate entrants.[75] In March 2013 it published its first comprehensive assessment of the impact of the reforms[76]. It found that full-time home and EU graduate numbers were 47,000 (12%) fewer than 2011/12 and 33,000 (9%) down on 2010/11. Full-time home and EU postgraduate student numbers were around 5% down on 2011/12 and 2% down on 2010/11. Falls in part-time entrants were substantially larger and are described by HEFCE as 'significant'. Part-time undergraduate entrants in 2012 were down by 40% compared to 2010 and there was a 27% reduction in part-time taught postgraduate entrants. Again the note HE in England from 2012: Student numbers gives more detail on this and the possible reasons put forward by HEFCE for the fall in part-time recruitment.

HEFCE has pointed out that the total value of resources available to institutions from 2012/13, after the expected fee income is included, is set to increase. Wider variations were expected at the level of individual institutions. The change in distribution of student numbers resulting from the new 'core and margin' allocation model is likely to mean a small shift in resources away from higher education institutions overall and towards further education colleges. It could also change the

73 Full-time undergraduate and PGCE entrants
74 *2012-13 Student number control limits*, HEFCE (March 2012)
75 Funding for universities and colleges for 2013-14: Board decisions, HEFCE. para 30
76 Higher education in England: Impact of the 2012 reforms, HEFCE

distribution of students, and hence direct and fee loan funding, between institutions. All institutions charging fees of £6,000 or more have additional requirements to provide access support for disadvantaged students. Higher fees may also create more general cost pressure from new students.

3.2 2013/14

HEFCE announced sector-level funding totals for academic year 2013/14 in February 2013.[77] Total recurrent teaching grant was set at £2.3 billion, down from £4.3 billion in 2011/12 and £3.2 billion in 2012/13.[78] Within this total mainstream teaching grant fell from £3.6 billion in 2011/12 to £2.4 billion in 2012/13 and £1.4 billion in 2013/14. Support for widening participation is to be cut by around one-third, smaller proportionate cuts are planned for 'other target allocations' and funding for improving retention is broadly maintained.

Initial allocations for institutions for 2013/14 were made by HEFCE in March 2013. Unlike in earlier years these have not been directly compared to allocations from the previous year. Student number controls for 2013/14 are included in the same document. While these are presented alongside the 2012/13 controls they include no estimate for the number of students no longer subject to controls ('ABB+' and equivalent for 2013/14) so do not give any estimate, however tentative, of the total intake (controlled plus unrestricted recruitment). Funding tables were updated in October 2013. These were relatively minor changes and adjusted allocations were made in March 2014 which showed some larger changes in funding. Final allocations were produced in October 2015.

3.3 2014/15

In March 2014 HEFCE announced sector wide funding allocations and initial allocations for institutions for academic year 2014/15.[79] Total recurrent teaching grant will be cut to £1.6 billion which includes funding for 30,000 additional entrants before the cap is completely removed in 2015/16. Within this the student opportunity allocation (formerly widening participation) has been increased by around 10%, but now includes what was the Access for Learning Fund. Recurrent grant for research remains as in 2013/14 and capital funding increases to £440 million. Adjusted allocations announced in March 2015 were virtually unchanged.[80] The £150 million cut in funding for (financial year) 2015-16 announced in June 2015 covers academic years 2014/15 and HEFCE's implementation cut its earlier teaching allocation for 2014/15 by £38 million through a 2.4% cut to all elements of teaching

[77] Funding for universities and colleges for 2013-14: Board decisions, HEFCE
[78] Funding for universities and colleges for 2012-13: Board decisions, HEFCE
[79] Recurrent grants and student number controls for 2014-15, HEFCE
[80] Annual funding allocations for 2014-15, HEFCE

grant.[81] Final allocations were produced in October 2016 which reflected revised data on student numbers.

3.4 2015/16

HEFCE's initial budget allocations for 2015/16 assume no change in funding in 2016-17 financial year; ie. those that will be announced after the General Election. Recurrent funding for teaching was cut to £1.4 billion, recurrent research funding was maintained at £1.6 billion. Total recurrent funding is cut from £3.5 billion to £3.3 billion; almost 6% in real terms. Capital funding increased to £600 million.[82]

The revised allocations made after the £150 million cut in teaching grant for financial year 2015-16 meant that HEFCE cut its teaching grant for academic year 2015/16 by £112 million. Final allocations announced in May 2016 see teaching funding of £1.37 billion and total recurrent funding of £3.07 billion.

3.5 2016/17 and beyond

Allocations for 2016/17 see recurrent grant for teaching reduced slightly to £1.33 billion and total recurrent funding very similar to 2015/16 at £3.06 billion.

High level decisions for 2017/18 have set the total budget for teaching at £1.32 billion and overall recurrent grant at £3.08 billion. Allocations for individual institutions are not expected until later in the year.

81 Reductions to HEFCE teaching grant for 2014-15 and 2015-16 academic years, HEFCE

82 Annual funding allocations for 2015-16, HEFCE

BRIEFING PAPER
Number 6206, 3 April 2017