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Higher Education – UK & Canada

Demographic trends and government policies are key social risks

The credit quality of public universities in the United Kingdom (UK, Aa2 stable) and Canada (Aaa stable) will continue to be subject to social risks arising from demographic trends and socially-driven government policy. Universities' primary mitigation strategies will be to strengthen competitiveness of student offerings and to diversify student intake through increased international enrolments.

» **Declining population of undergraduate age in the UK and Canada will pressure enrolment and increase competition**. Domestic undergraduates comprise the largest proportion of students entering universities in the UK (69%)[1] and Canada (68%)[2]. However, the population of undergraduate age has been declining and is expected to continue to fall over the medium term. This will pressure undergraduate enrolment figures and increase competition among universities for a smaller pool of applicants.

» **Government controls on domestic student tuition fees will exacerbate demographic pressures.** Restrictive tuition fee policies in both the UK and Canada will impede universities' ability to raise fees to compensate for fewer students.

» **Efforts to mitigate pressures are leading to extra borrowing.** Universities have ramped up their borrowing and capital spending to secure a competitive advantage and adapt to changing consumer expectations.

» **Universities can rely on a number of measures to offset demographic and government policy pressures.** Universities will continue to invest in enhancing their student offering in a bid to boost competitiveness through tailored academic programmes. In the UK, a concurrent increase in the participation rate will partially offset the declining undergraduate population.

» **Increasing international student numbers and fees can offset domestic revenue constraints**. To provide additional revenue in the face of domestic revenue constraints, rated universities in both countries are focused on increasing the number of international students.

» **More supportive immigration policies in Canada underpin universities' ability to increase international students.** Within a more supportive policy environment, universities in Canada have recorded international student growth of 22% over three years compared with only 5% in the UK. At a national level, the UK has lost global market share in the context of a less favourable immigration policy.

Declining undergraduate age population in both the UK and Canada will pressure enrolment and increase competition

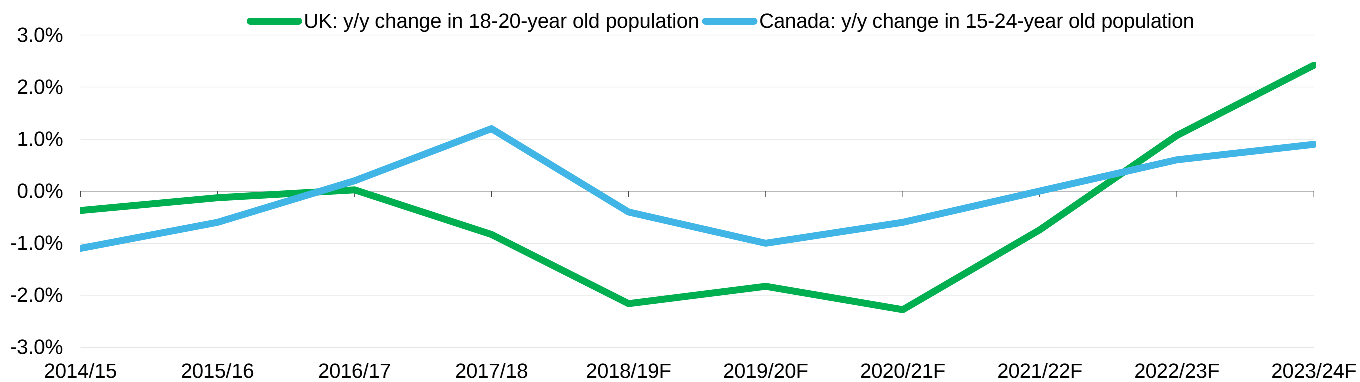
Domestic undergraduates comprise the largest proportion of students entering universities in the UK (69%) and Canada (68%). However, the undergraduate age population has been declining in both countries and is expected to continue to fall over the next 2-3 years. This decline is pressuring undergraduate enrolment figures and increasing competition among universities for a smaller pool of applicants.

In the UK, the 18-20 year old cohort has declined in four of the last five academic years. Further declines are likely until 2021/22, but this trend is expected to reverse in 2022/23 (see Exhibit 1). Reflecting this demographic shift, the number of total applicants for full-time undergraduate courses in the UK decreased by 0.6% in 2018 to approximately 696,000, the lowest number since 2013[3].

In Canada, the population of undergraduate age is also expected to decline over the next two years (by an average of 0.8% a year), before reversing in 2022/23[4].

Exhibit 1

Population trends for UK and Canadian universities will remain unfavourable over the medium term
(Year-on-year growth in population, 18-20 year olds in the UK, 15-24 year olds in Canada, 2015-24)



Source: UK: Office for National Statistics, Canada: MoodysEconomy.com

This demographic shift in both the UK and Canada will continue to fuel competition for undergraduate students over the next 2-3 years. To meet targets for student growth, we expect that universities will continue to strengthen their strategic efforts around recruitment, marketing, academic offering and campus experience. Universities may also try to mitigate pressures by lowering academic standards and increasing their acceptance rate to boost numbers. However, we expect this strategy to be limited, given that it can negatively impact a university's reputation.

Government controls on domestic student tuition fees will exacerbate demographic pressures

Limits on domestic undergraduate tuition fees have been set by the UK central government and by several Canadian provinces, driven by budgetary or political pressure. Limits include fee caps, tuition freezes or outright tuition reductions. While these policies are intended to ensure more equitable access to higher education, they pressure university credit profiles as they can result in lower revenue growth, and revenue declines in some cases.

In the UK, domestic tuition fees are capped at a maximum of £9,250 a year, and a freeze has been in place for two years. Policy on tuition fees has been volatile, making it difficult for universities to plan ahead. For example, policy announced in 2017 which would have allowed universities to increase fees based on inflation, contingent on meeting teaching quality criteria, did not materialise. A government commissioned report, published in May 2019, recommended a reduction in the tuition fee cap (with a government top up) and a freeze on tuition fees for another three years. If implemented, this would be credit negative for rated UK universities[5].

In Canada, tuition frameworks are set at the provincial level, with provinces typically able to regulate tuition fee growth for domestic students. Ontario (Aa3 stable) currently has one of the more restrictive tuition fee policies in the country, with a provincially mandated 10% tuition fee cut for domestic undergraduate students in 2019/20, followed by a freeze in tuition levels for the 2020/21 academic year. As a result, universities face operating pressures, with operating revenue declining by 2%-4% in 2019/20. In British Columbia (Aaa stable), the provincial government currently caps domestic undergraduate tuition fee increases at a maximum of 2% (on average across all programs), while Quebec (Aa2 stable) set 2019/20 annual increases at 3.6% for its residents and 4.0% for the rest of Canada. As a result, universities are constrained from increasing a significant revenue source, and therefore face the need to find alternative strategies to offset these pressures.

Efforts to mitigate pressures are leading to extra borrowing

In order to secure a competitive advantage, and to adapt to changing consumer expectations, universities have ramped up their borrowing and capital spending to maintain the quality of existing infrastructure and fund significant new teaching, research and student support infrastructure projects. In addition, as international students (which are an increasing share of the student population at universities), favour on-campus accommodation over off-campus options, there has been significant capital spending on building additional housing facilities.

The University of Southampton (Aa3 stable) in the UK, for example, issued a £300 million bond in 2017, which will partially fund £621 million of capital spending over the next seven years to enhance the university's appeal (see Exhibit 2). Investment is focused on new teaching and research facilities, as well as improving its website and digital customer service.

Since 2016, there have been a wave of debt offerings from Canadian universities to support large-scale capital projects for campus renewal, new or modernized teaching and research facilities, and to address deferred maintenance issues. Debenture issues for capital projects include CAD160 million in 2016 from McGill University (Aa2 stable), CAD130 milion in 2017 from Ryerson University (Aa3 stable) and CAD85 million in 2018 from the University of Saskatchewan (Aa2 stable).

Exhibit 2

UK and Canadian universities have increased borrowing to invest in capital projects
(Public bond issuances for UK and Canadian universities since 2016)

Name	Rating	Issue Date	Face Value (millions)	Currency	Maturity year
Cardiff University	Aa3	Feb-2016	300	GBP	2055
University of Leeds	Aa3	Feb-2016	250	GBP	2050
University of Southampton	Aa3	Apr-2017	300	GBP	2057
University of Oxford	Aaa	Dec-2017	750	GBP	2117
University of Cambridge	Aaa	Jun-2018	300	GBP	2068
University of Cambridge	Aaa	Jun-2018	300	GBP	2078
McGill University	Aa2	Jan-2016	160	CAD	2056
University of Ottawa	Aa2	Oct-2016	200	CAD	2056
University of Windsor	Aa3	Jul-2017	40	CAD	2057
Ryerson University	Aa3	Oct-2017	130	CAD	2057
University of Regina	Aa3	Dec-2017	79	CAD	2057
University of Saskatchewan	Aa2	Mar-2018	85	CAD	2058
Concordia University	Aa3	Feb-2019	50	CAD	2059
Concordia University	Aa3	Feb-2019	25	CAD	2039

Source: Moody's Investors Service

Universities can rely on a number of measures to offset demographic and government policy pressures

We expect universities to continue to strengthen their efforts to gain or maintain market share from the declining pool of undergraduate students. UK universities will continue to focus on improving their branding and market position, and Canadian universities will differentiate themselves from peers through provision of a better campus experience and specialized programs (including language programs, support groups and an emphasis on innovative program offerings). A recent government commissioned report in the UK notes that universities have increased and refined their marketing in a bid to attract students.

Some Canadian universities have also been able to respond to funding pressures by controlling operating or capital expenses, although most universities have limited capacity to do so. For example, the University of Ontario Institute of Technology (UOIT, A1 stable) is seeking to reduce annual spending by 1.8% overall per its 2019/20 budget. Several universities, including the University of Regina (Aa3 stable), have begun to offer alternative courses outside of the daytime classroom setting. These include online, evening, summer and hybrid courses, or using sessional instructors, which have significantly lower overhead costs. Universities can also mitigate (some) pressures by launching new programs and teaching streams, which can typically be priced independently of the provincial fee framework, as well as increasing international student tuition fees and enrolment numbers (which are typically not subject to provincial controls).

At a national level, adverse population trends can also be mitigated by an increasing higher education participation rate. The UK participation rate stood at 51% in 2018 (of 25-34 year olds having completed tertiary education). In Canada, the participation rate was 62% in 2018, the second highest participation rate among OECD countries[6]. Given its relatively low rate compared to Canada, the UK has a greater potential to benefit from a higher participation rate – the government forecasts that continued participation rate growth will partially mitigate the declining population trend.

Expenditure flexibility for UK universities is constrained by rising pension costs and limited control over staff pay increases (which are set at the national level between unions). The primary mechanism for controlling staff costs is through voluntary redundancy schemes. For example, in the face of operating deficits and high staff costs, Cardiff University (Aa3 negative) recently implemented university-wide recruitment controls and a voluntary redundancy program, which aims to reduce a net total of 380 positions over the next five years.

Increasing international student enrolment and fees can offset to domestic revenue constraints

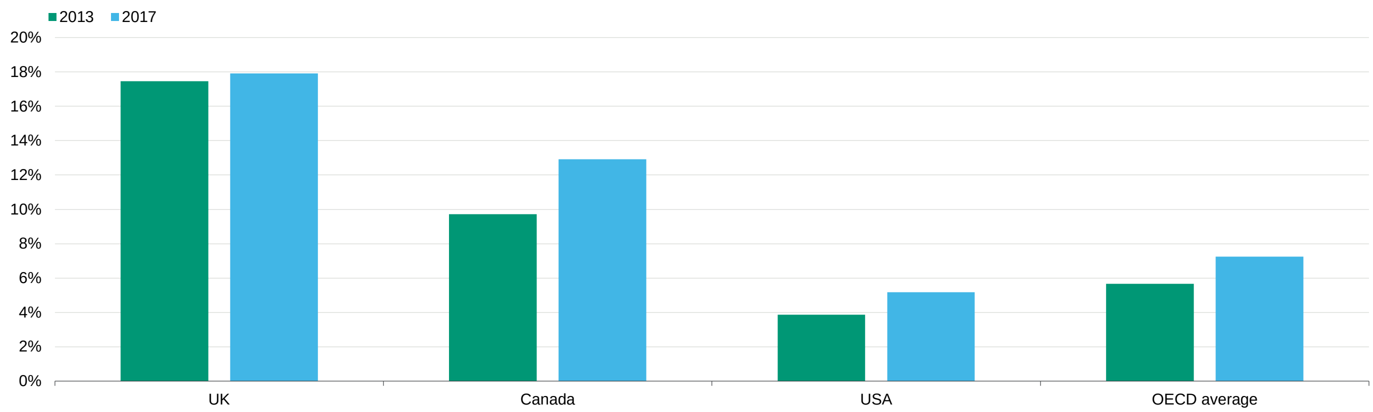
To mitigate the revenue impact from both a declining undergraduate age population and domestic tuition fee policies, rated UK and Canada universities are seeking to increase revenues through their intake of international students (for which they have significant ability to increase fees).

Over the last decade, the share of international students across the majority of UK and Canadian universities, has risen – international recognition of these universities has increased/remained very strong, while global living standards have improved. Given universities' ability to set international tuition fees much higher than those for domestic students, they have become a key revenue source to subsidize lower domestic tuition fees, offset domestic demographic pressures and mitigate the cost of inflation of salaries and pension benefits.

The rise in international demand and enrolment, however, exposes universities to credit risk from geographic concentration (particularly of Chinese students). Nevertheless, universities have largely recognized this risk and continue to try to reduce it through diversification of international students, including those from elsewhere in Asia (India, Vietnam, Korea) and other regions (Latin America, Middle East, Europe).

Immigration policy plays a significant role in attracting or deterring overseas students, which is especially important given the relatively high proportion of international students in both countries (see Exhibit 3). As a result, the success of international student growth strategies is largely dependent on national immigration policies.

Exhibit 3
Both the UK and Canada have above-average exposures to international students
(Percentage of international students in tertiary education, 2013 and 2017)



Source: OECD Education at a Glance 2019

UK universities are more exposed to potential fluctuations in demand, given that international students – including those from the European Union (EU, Aaa stable) – represent a larger share of total university enrolment at 20% in 2018, compared with 15% in Canada[7]. Canadian universities, on the other hand, have been relatively successful in attracting international students over the last few years, given their increased attention to campus offerings, flexible classroom environment, considerable support networks for international students, post-graduation skilled labour opportunities and overall favourable immigration policies.

More supportive immigration policies in Canada underpin universities' ability to increase international student numbers

Broad-based social attitudes can influence immigration policies. In Canada, supportive student immigration policies at both the federal and provincial levels will continue to provide a competitive advantage for universities compared with their UK peers.

Canada's federal policies allow students to work part-time on or off campus during their studies without a work permit, and they can qualify for one between eight months and three years after graduation. In addition, qualifying international students who graduated in Canada are given preferred status when applying for permanent residence status (see Exhibit 4). As a result of these policies, Canada has been more successful at attracting international students than the UK, with growth of approximately 22% over the last three years compared to only 5% in the UK.

In the UK, immigration policy governing international (non-EU) student immigration has been more volatile. Recent announcements signal a more supportive policy in an effort to reverse the trend of declining market share. In March 2019, the UK government announced plans to increase the number of international students to 600,000 and the value of education exports to £35 billion by 2030. In September 2019, the prime minister announced significant changes to post-study work options for international students – international students will be allowed to work for up to two years following graduation, compared with the four month limit imposed in 2012.

These recent changes are credit positive for UK universities, but remain less favourable than those in Canada. Over the last decade, policy has intended to deter international students as part of a wider strategy to reduce overall immigration. In 2012, the UK government abolished a post-study work visa, which allowed international students to remain and work in the UK for two years after graduation. Following this change, the number of Indian students studying in the UK fell by half over a two-year period – to around 20,000 by 2012/13 from 40,000 in 2010/11, and has remained below 20,000 since[8].

Policy surrounding the status of EU students in the UK (following the UK's departure from the EU) remains uncertain. Students from the EU are currently entitled to "home status" – they pay the same fees as UK students and have equal access to student loans. While the UK government has guaranteed home status for students beginning in 2019/20 and 2020/21 (for the duration of their course), it has not determined its policy from 2021/22. We note that if EU students are charged higher international fees, UK universities could have the opportunity to increase revenues.

Exhibit 4

Canadian immigration policy for international students is more supportive than in the UK
(Summary of immigration policies affecting international students as of 2019)

Country	UK	Canada
Level of government responsible for immigration policy	Federal government	Federal government, but provincial laws could influence immigration
Ability to work while studying	International students studying for more than six months are required to obtain a visa. Most will obtain a Tier 4 (general) student visa which allows students to work but with restrictions: full-time students can work for up to 20 hours during term time and full time during vacations.	International students in Canada with a study permit and enrolled fill time in a college or university can work on or off campus, without a work permit
Ability to work after graduation	Currently: international students graduating from a UK university can work in the UK for up to four months after graduation. Starting 2020: international students graduating from a UK university can qualify to work in the UK for up to two years after graduation.	Post-study work permits allow international students to work anywhere in Canada and for any employer for up to 3 years after graduation
Permanent Residency (PR) status	There is no direct route to PR for international students as the Tier 4 student visa is for short-term study in the UK. International students need to fulfill a number of other criteria before being eligible to apply for UK PR. It often takes a minimum of five years post graduation to attain eligibility for PR.	Skilled Immigrants Express Entry program for Canadian diplomas/degrees and for qualifiable work experience in Canada. International students can apply as soon as they meet the requirements, which may take as little as 1 year.

Source: UK Home Office, Immigration, Refugees and Citizenship Canada

Moody's related publications

Sector research

- Higher Education – Canada: 2019/20 budgets of Ontario universities indicate that tuition fee reductions are manageable over the short term, September 2019
- High Education - United Kingdom: FAQ on sector resilience in the face of a challenging operating environment, August 2019
- Higher Education - UK: Rising staff costs and pension contributions to exert financial pressures on universities, April 2019
- Higher Education - UK: Increase in international and EU student applications despite Brexit uncertainty is credit positive for UK universities, February 2019
- Higher Education – Canada: China-Canada diplomatic tensions pose credit risks for Canadian universities, February 2019
- Higher Education – Canada: Reduced university tuition is credit negative for Ontario's higher education sector, January 2019
- Higher Education - UK: Emergency loan to university supports our assumption of high extraordinary support, November 2018

Issuer research

- University of Southampton (United Kingdom): Update following change in outlook to stable from negative, May 2019
- Cardiff University: Update following rating affirmation, May 2019
- McGill University (Canada): Update to credit analysis, January 2019
- University of Saskatchewan (Canada): Update to credit analysis, January 2019
- Ryerson University (Canada): Update following rating downgrade, December 2018
- University of Regina (Canada): Update to credit analysis, December 2018
- University of Ontario Institute of Technology (Canada): Update following upgrade of rating, October 2018

To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.

Endnotes

1 Figure includes students from the EU who have "home student" status through 2020/21.
2 Source: Statistics Canada, CAUT.
3 Source: End of Cycle Report 2018, UCAS.
4 Source: Moody's, Statistics Canada.
5 Source: Independent panel report to the Review of Post-18 Education and Funding, May 2019.
6 Source: OECD (2019), Education at a Glance Database.
7 Source: Higher Education Statistics Agency 2018 for UK; Statistics Canada.
8 Source: UK Foreign Affairs Select Committee, Building Bridges -Reawakening UK-India ties.

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