NEW COLLEGE FINANCES REVISITED

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NEW COLLEGE
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1. Introduction

Two events have suggested revisiting this subject, last addressed in 2007 (in the bulletin circulated in early 2008). First, tuition fees at UK universities have recently attracted great attention in all three of the Government, the media and the universities themselves: it is only natural to ask what will be the impact of the changes on New College. Second, it is equally natural to enquire what has been the impact on the College of the financial crisis – indeed cataclysm – which broke over the world just after the previous bulletin went to print.

I hope that this note helps address these questions, and also a topic both implicit in the second question and often asked explicitly: how does New College determine the spend rate from its endowment?

2. The Underlying Basis for College Spending

At 31st July 2010 there was roughly £110 million of liquid investable assets between the College and the Development Fund, plus over £30 million of less liquid College assets such as property. Governing Body needs to decide how much the College spends each year from this resource base while still leaving us in as good a long-term financial condition as we started, i.e. allowing the current level of real activity to be sustained indefinitely – or increased with additional funding.

This entails estimating the rate at which our costs will increase, retaining (or re-investing) the amounts from investment returns to meet these costs long-term – and spending the difference now. The numbers currently are:

1. NC liabilities are expected to increase long-term at ~RPI+2-2½% per annum, and inflation to be 2-2½ % per annum (both in Sterling). That means we need to grow our financial asset base over the long term at 4-5% per annum.

   RPI+2 may seem low for cost inflation at New College: private schools reckon on up to RPI+5. NC's experience is that with ongoing savings that do not affect teaching and research quality, we can live with RPI+2-2½, broadly in line with salaries in the UK economy as a whole. However, to go lower would be risky because academic salaries have fallen relative to other professions. For example, the post of College Accountant was advertised last year at a College salary similar to a tenured professor: the relative downtrend in UK academic salaries needs to reverse if the quality of Oxford faculty is to remain world class.

2. A reasonable expectation of the long-term total return on our portfolios is 7½ –8½% per annum in cash terms (say 5½ - 6% real). That may sound high in the current world, but even in the six years to July 2010 we earned over 8% cash return p.a. on our investable assets in a very low interest-rate environment covering a huge financial crisis.

New College has received Privy Council consent to amending its statutes to use total return accounting for its investment returns: our published accounts show the transfers to and from the capital reserves. The total return approach alleviates the need to slavishly spend only the cash that actually arrives labelled 'income': however, prudence dictates aiming for actual cash flow within our investment returns which is at least within sight of our operational cash outflow.

3. Deducting 2-2½% real for cost increases from 5½-6% real expected return leaves 3-3½% of the return on our assets available to spend: a little lower, say 3-3¼%, if we want a safety margin without penalising the current generation.

US universities use spend rates up to 5% per annum. This arises from two sources. First, a much more aggressive investment policy, which looked fine until the crisis when some Ivy League endowment values fell by about one third. Second, they have enjoyed a much higher alumnus donation rate: a reliable stream of donations allows increased spending. I prefer New College to stick with a 3% to 3½% spend from the return on our endowment base.

New College Development Fund is a separate charity with a majority of alumni Trustees. NCDF supports from its own resources activities such as part of the development office cost, Junior Research Fellowships, a programme of small grants for student cultural and sporting activities which seem to be warmly appreciated, and purchasing one-off items like a new practice piano. NCDF also acts as a conduit for donations to the College, including from the American Friends of New College or for refurbishment projects. Much of the expenditure met by NCDF is or would be ongoing College expenditure: around £600k in 2008/09 and £800k in 2009/10 (excluding student support). Hence the analysis of spend-rate is best applied across the combined College and Development Fund balance sheets.

3. General background

Oxford University has over 19,000 formal students in total (up from ~16,000 ten years ago, but now not likely to grow further). New College currently has 700 active students, of which ~410 are being taught for an undergraduate course (e.g. excluding those abroad), around 80 are taught graduates and 210 are graduate research students (a few part-time) plus some visiting students. About 28% of our undergraduates are on 4-year courses. The great majority of undergraduates live in College accommodation, plus around half the graduates.

New College has reversed an earlier decision to trim its number of undergraduates and expects to matriculate around 125 undergraduates this coming academic year – as it happens, the same number as 1967, when I matriculated. This will become about 30 more active undergraduates going forward than we showed in 2007, but with about the same number of teaching faculty: 56 (Tutorial Fellows and others). Of these posts 17, which provide approaching half of all the undergraduate teaching hours in New College, are paid for by the College without support from the University, but sometimes shared with other colleges. About 5 of the Tutorial Fellows are on sabbatical at any one time.

Our current humanities/STEM (Science, Technology, Engineering, Maths) split of students and faculty is unaltered at around 60:40 but this is now under external threat. One of the outcomes in the Government funding review has been to emphasise STEM subjects, because they are believed to contribute more to the UK economy. The new system will fund research on STEM subjects but not humanities. Secondly, the University now may lapse humanities posts when an incumbent retires. Much New College development activity has therefore focussed on endowing humanities posts in order to maintain the subject balance of College teaching and research. I was reminded of this when I recently read the autobiography of Sir Rudolf Peierls, a very eminent theoretical physicist who gave up his long-standing chair at Birmingham to become Wykeham Professor for 1963-74. He cites the multifaceted cultural life of Oxford as a main reason that he decided to come to Oxford and New College.

Another core activity revolves around music: one of the great and enduring glories of New College. The choir, the choir school and the chapel are all part of the legal entity that is New College: in 2009/10, they together received total income of just over £1.3 million but incurred costs of just over £1.6 million. Another great and enduring glory is the College's physical fabric: our buildings, gardens and chattels. They also have not changed in the past few years, nor has the ongoing real cost of maintaining them, which the College bears with no external funding – bar only about £30K per annum of net receipts from gate admissions.

The UK Government, under the system about to be swept away, currently funds teaching and research mainly through the Higher Education Funding Council for England. HEFCE pays Oxford University for UK undergraduate and graduate students, leaving the University to collect the amount of the grant calculated to be fees due from the students themselves. Oxford University passes onto colleges their share of both the grant and collection responsibility from students. Within the words 'their share' lies a great mystery called the Joint Resource Allocation Model (JRAM). Suffice it to say that New College received around £5K per active undergraduate in 2009-10 or £2.2 million in total. External to JRAM, New College typically also receives about another £200K p.a. in fees (e.g. foreign students, year-abroad students or inter-college tuition fees). Against the total fee income, over £400K is spent each year on student clubs and support (undergraduate and graduate) between the College and NCDF.

Thus while tuition fees represent a major part of why New College exists at all, they currently represent only about one seventh of our gross income.

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4. Progress in the Last Four Years

There is a saying in my world that a bear market or difficult economy improves the relative position of the well-managed, and can eliminate the very poorly managed. So what has New College done in the past four years?

Student numbers are increasing as above, and the College has not at all sought to alter its admissions policy to source higher-paying 'customers'. No academic posts or significant cultural events have been lost. Thus our level of real activity has been maintained or slightly increased.

In financial terms, in the year before the last booklet was written (that to 31st July 2006) New College just about broke even on total revenue (including investment income) of £10 million. The 2009-10 accounts show revenue of ~£12.4 million, up 5.7% p.a. compound from 2005-06, or 2.6% real: staff costs at ~£6.5 million are up by a marginally lower percentage than revenue. Comparing the two sets of accounts, therefore, suggests a reasonable four-year pattern in managing the College's affairs.

However, in 2007, we anticipated 2011-12 fee income approaching £3 million (2009-10 £2.5 million) and investment return up to £4.9 million (2009-10 £4.0 million) so both these sources of income are unlikely to meet the previous estimates for 2011-12: the external squeeze has already begun to take effect. Approximately £100K p.a. has been saved by eliminating non-academic posts, while twenty extra undergraduates will add income of £100K p.a. or so: together £200K p.a. in 'productivity gains', which will rise with inflation. Many refurbishment or major repair projects have been put on hold: this is wise from a cash-conservation perspective during a squeeze but does not usually save final costs.

External engagement with the College – the development / alumni engagement effort – has continued to grow over the past four years. Our participation rate (the proportion of the Old Member database contributing to the College in any year) has risen from 15% to 19%. The amounts received comprise £3.7 million from live donors, two or three times more than in the preceding four years, plus £1.5 million from legacies. In addition, making a total of £6.7 million, there is over another £1.5 million which is fully committed

and will be received during the next 12 months and includes permanent endowment of the post currently held with such distinction by Edward Higginbottom.

As it happens, the majority of this funding is technically spendable, not permanent endowment, But, endowment of two further posts is under discussion with potential donors. Another initiative has generated donations to fund current scholarships for outstanding D.Phil. students to come to Oxford and New College: we have nine such among our current postgraduate research students.

For the future, 65 new legacy pledges have been made in the past four years: legacies are a very important source of gifts but one for which the donors, if I am typical of them, hope that the actuaries are right that it may be many years before funds actually pass! Finally and importantly, the '2019 Committee' is focussing on expanding this whole approach, working with the Development Office and, from my observation, with the whole-hearted support of the Warden and Fellows, and even the JCR and MCR.

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5. New UK tuition fee regime and its effects on New College

As we saw in 2008, a tutorial system needs endowment income to sustain it. At present New College tutorial teaching (for which the fees have not kept pace with inflation over 5 or 6 years, never mind RPI+2) is subsidised to the tune of £7-8,000 per undergraduate per annum: excluding the support for research, tutorial teaching costs around £14K p.a. per student at college level, or £18K including the University part.

As we shall see, the new system will not improve the position much if at all for New College, despite the much higher fees allowed to be charged by universities for undergraduate teaching, and the correspondingly higher repayments – via income tax – from affluent students.

As a civil servant friend of mine says, the public sector is a bus driven by a one-legged bus-driver, who currently has his foot firmly on the brake, not the accelerator, and Higher Education funding is no exception to this analogy. The HEFCE grant under the current system will be cut in the immediate future, and the new long-term mechanism will apply to UK students admitted from the 2012-13 academic year onwards, will work its way through universities and New College over 3 to 4 years, depending on the length of their courses, and be in full effect from 2015-16.

Under the new system universities may charge 'Home' (i.e. UK and EU) students up to £9K per year for undergraduate teaching, probably assumed to be the full cost of their education. Oxford University, like many other Russell Group universities, has opted to utilise this maximum though University fee waivers for the least well-off would reduce the average fee charged by Oxford to about £8.5K. HEFCE grants will be withdrawn but HEFCE will transfer to the University 'fee vouchers' about half of which will be spent on a sliding scale of support and fee waivers for students from poor backgrounds. As now, JRAM will allocate the HEFCE income between the University and colleges: in March 2011 the University agreed the parameters for the new system.

From the student side, they will be obliged to contribute, as a 9% tax on annual income of theirs over £21K per annum, the amount of their university fees that remains after the means-tested support outlined. For the majority of students – i.e. those deemed sufficiently affluent – the tax obligation will be the full fee charged, i.e. for Oxford £9K per annum.

Note that unlike the current £3.4K fee cap which rises with the RPI, there is no promise that the £9K fee cap will rise in line with RPI.

Out of this whirling set of figures, and the decisions made within Oxford itself, the estimate is that New College will certainly experience an immediate dip in income of around £150K per annum. Furthermore, were the new fee system fully operative now, we would be little if at all better off than 2010-11 – while some of our students will ultimately be paying over two and a half times as much for their education!

This is also a good place to mention that undergraduate accommodation and board at Oxford are usually better quality than at other universities – and often cheaper since students only pay during term-time, not the 51- or 52-week contracts normal for commercial accommodation for students.

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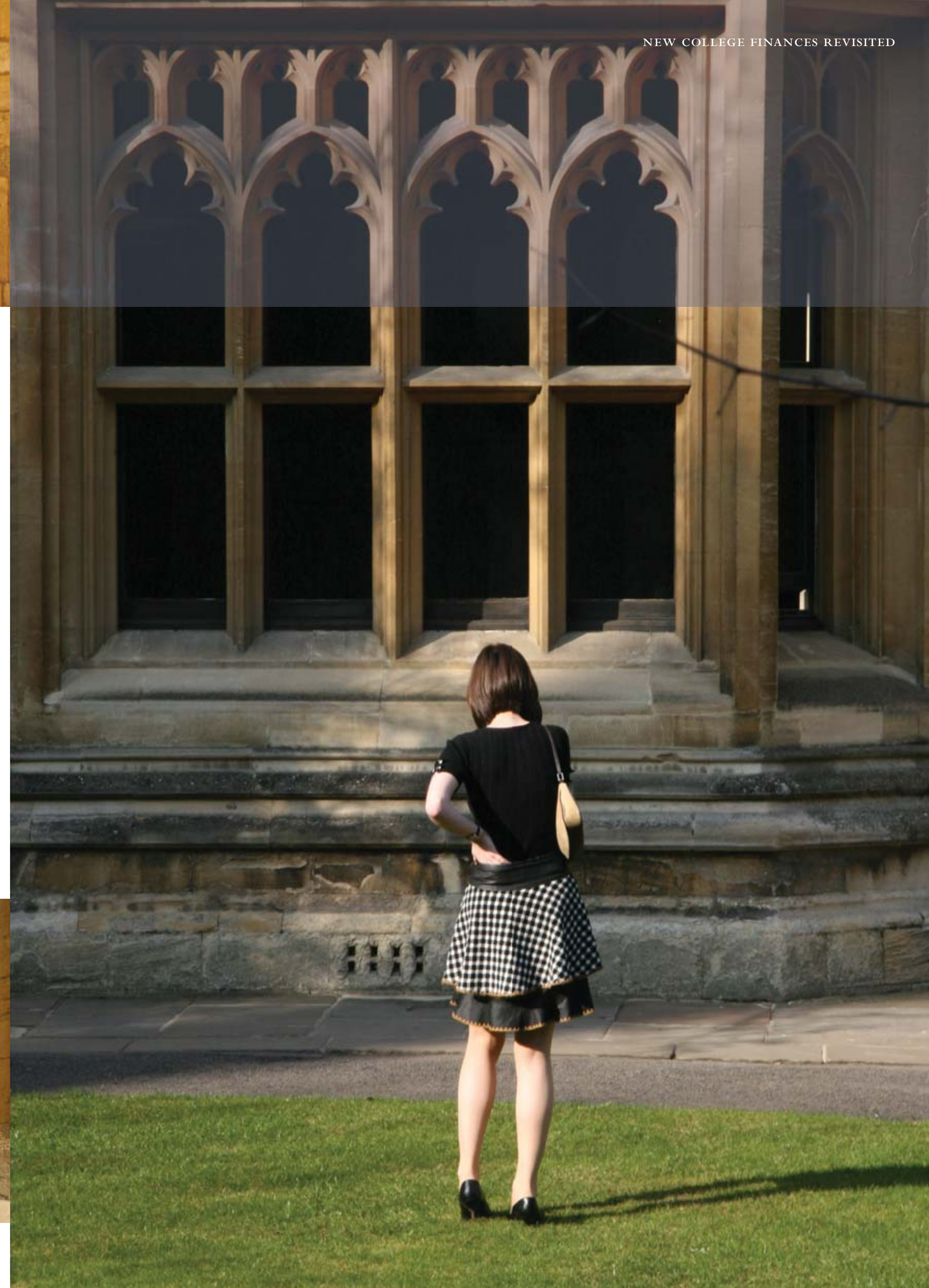

6. Summary of Effect to Date of Financial Crisis

These data suggest that there has been a squeeze on College annual cash-flow of around £500K p.a. over the past four years, partly met by internal economies and deferrals. However, the potential for long-term damage from these pressures should not be underestimated: even leaving aside the accumulating backlog of major fabric repairs, our academic gross salaries will fall by about 3% real in the current (2010-11) academic year and the same again next year: this is against the background of academic salaries having fallen behind those in the UK economy as a whole.

There are further negative effects just starting: the increases in VAT, carbon retention 'tax' and National Insurance: together these will cost the College about an additional £150K p.a. – as much, if they are sustained, as any eventual increases in fee income.

As regards our asset base, over the 6 years to 31st July 2010 the return on our endowment assets was around 17.4% per annum, but this credits all the £50+ million gain on Aylesbury in 2004-05, whereas it arose over 10 years or so up to 2005 (and the actual proceeds were received over two subsequent years). My estimate of the result of removing 'the Aylesbury anomaly' – by the way, can we please have some more such anomalies! – suggests a return for this 6-year period of about 8% per annum. Within this, later years were mainly more difficult which is why our asset values have not grown as much as we estimated in 2007, but the difference is not irrecoverable, with our investable assets at 31st July 2010 standing at ~£144 million including the Development Fund. The income component of our return was lower than usual, but we have not at all been forced sellers of any assets.

Another effect on us is that UK property development timetables have generally moved back 2 or 3 years, pushing back these potential additions to our endowment assets: this applies to our land at Banbury mentioned last time, and to one of our commercial property assets. However, overall our balance sheet seems to have coped with the crisis reasonably well.

7. Current Financial Position and Projections

The table below is based on the 2009-10 income and expenditure account and is set out similarly to 2007, but with the operating deficit shown explicitly to highlight how dependent we are for our operations on current donations and the return on our accumulated assets.

(Please note that 'grant and donations' shows the annual benefit of donations, not the capital value of endowment gifts.)

Ten-Year Financial Projection
(2009/10-2019/20) – as per published accounts (Pro-forma combination of New College and NCDF)

£'000	College Actual 2009/10	College + NCDF Actual 2009/10	Combined Projected 2012/13	Combined Projected 2019/20 Donations half*	maintained**
Total Revenue from Services (ie without investment return or donations)	7,078	7,082	8,100	10,000	10,000
Results					
Core Academic Activities Net fee income less direct costs	(1,238)	(1,238)	(1,200)	(1,900)	(1,900)
Student Support etc.	(466)	(573)	(650)	(900)	(900)
Accommodation & catering Revenue less direct costs	(130)	(130)	(150)	(200)	(200)
Establishment Costs & Miscellaneous Cost/Income	(3,528)	(4,102)	(4,100)	(5,700)	(5,700)
Choir School	(207)	(207)	(220)	(300)	(300)
Operating (Deficit)/Surplus	(5,569)	(6,250)	(6,320)	(9,000)	(9,000)
Grants & donations expendable in year	910	1,598	2,000	900	1,400
Investment Return net of inv. management costs and interest paid	4,023	4,305	4,600	6,600	7,200
Net Result	(636)	(347)	(280)	(1,500)	(400)
N.B Endowment Assets £M	*133*	*144*	*154*	*218*	*230*

† for projections: nearest £100K for income: nearest £1M for assets
*halved after 2010-2011
** £1.5M per annum, 50:50 current: endowment, all increasing at RPI+2% per annum

In contrast, the central University has very different financial characteristics: in 2009-10 its investment income was only 3% of revenue totalling around £880 million (as did expenditure), compared to our 30%. In fact, including grants and donations, over 40% of New College's expenditure is met via past or present donations.

I draw two conclusions from this financial snapshot for New College:

(i) However careful New College continues to be with its money, its very high standards for physical fabric, teaching, research and other cultural activities cannot be sustained without financial damage, unless endowment return and donations together continue to cover at least the same proportion as now of expenditure.

This broadly means donations continuing at recent average levels and growing at least 2% in real terms. The negative cumulative impact, were new donations hypothetically to halve after this year while activity is maintained, can only be estimated: it looks like £1.5 million annual deficits by 2020 after investment transfers, and over £10 million of capital already consumed; and

(ii) We are not about to let the gardens go to weed or to cut faculty or student headcount, but additional endowment of £50-100 million i.e. £30-70 million more than the current donation rate – or a mix-and-match with the equivalent annual spending power of roughly £1.5-£3.0 million – would make the long-term position very much more comfortable and enable us to look at headcount increases: these figures exclude any new buildings. Indeed this would be a strong base for seeking an even higher breadth of intellectual achievement.

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8. Looking Forward Again

How are we presently placed then to sustain our mission of being...

...a leading multi-disciplinary community of students, teachers and researchers, housed amid cultural excellence?

Our core functions seem unimpaired. Indeed qualitatively they seem to be prospering, and financially we have our head above water – just. Does that suggest that we can relax with a sigh of relief? Not yet, I am afraid. As can be seen from the numbers above, there is a lot more of the same to be done so that New College emerges from under the foot of the one-legged bus-driver as a flourishing academic community, set for another century of the same.