

SUPPLEMENTARY SUBMISSION TO THE SENATE EDUCATION AND EMPLOYMENT LEGISLATION COMMITTEE INQUIRY ON THE HESLA BILL

8 August, 2017

Universities Australia (UA) is pleased to make this supplementary submission to the Senate Education and Employment Legislation Committee's inquiry into the *Higher Education Support Legislation Amendment (A More Sustainable, Responsive and Transparent Higher Education System) Bill 2017*.

In particular, we would like to address comments about university financing made by witnesses at public hearings which the Committee conducted on the Bill on 24 and 25 July 2017.

BASE FUNDING PER PLACE

The Department's projections of base funding per place over forward estimates – assuming the Bill is passed – emphasise that base funding will be higher in both nominal and real terms over the out years than levels observed in 2009.

The statement misses the point. The Government's package is primarily a Budget saving measure. It is explicitly and deliberately designed to reduce resourcing per place below current levels. In particular, the Government is proposing to reduce public funding for universities below current levels, which are already the second lowest of all countries in the OECD.

Central to the Government's package is a significant cut to the Commonwealth Grant Scheme (CGS). By 2021, CGS spending per place will be 10.3 per cent lower in real terms than it is today. Over forward estimates, the Government will cut around \$1.9 billion in cash terms – the biggest share of a total of \$2.8 billion in cuts to higher education.¹

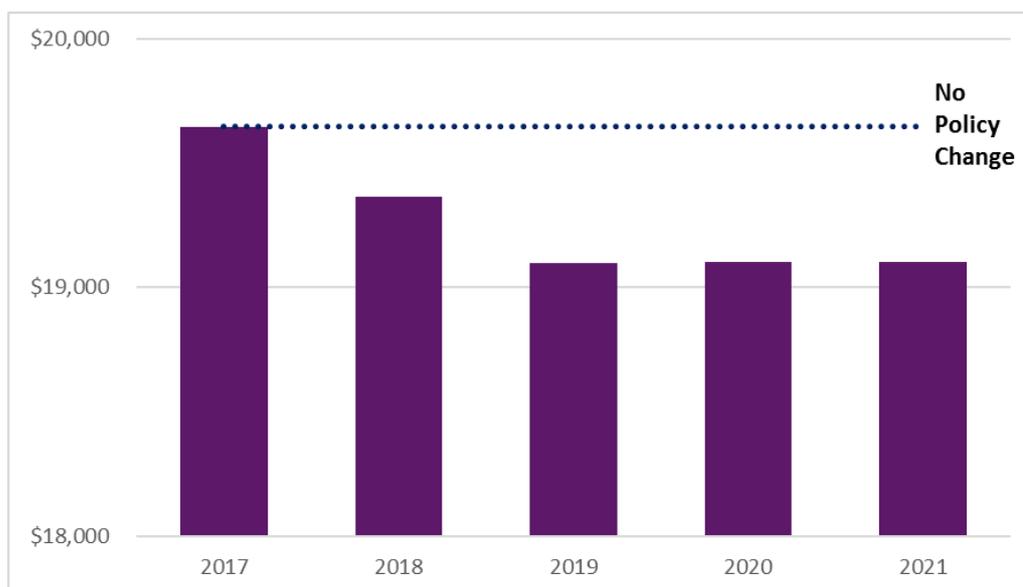
The Government's figures include the proposed increase of 7.5 per cent in student contributions. Even including this fee increase, total resourcing per place will be lower than current levels. This is the effect of the so called 'efficiency dividend', which will take \$1 billion out of the sector over forward estimates. As a result of the efficiency dividend, the net impact of the proposed changes on resourcing per place will be a permanent reduction by nearly five per cent from 2019 onwards.

If the legislation is passed, we estimate that base funding per student place would drop from around \$19,650 in 2017 to \$19,370 in 2018, and around \$19,100 in 2019 and beyond.

This would be a real cut to funding per place over the next four years.

¹ UA analysis of Commonwealth Budget papers, 2017-18

Figure 1. Estimated average base funding per place to 2021 (in constant 2018 dollars)



Notes: UA estimates based on 2015 discipline mix.

Another key assertion made by Government has been that overall **revenue** – as distinct from Government funding – to universities would continue to grow over the forward estimates period. This statement is based on projections that make some ambitious assumptions.

These include a projection that once New Zealanders and other permanent residents no longer have access to a Commonwealth-supported place and instead would pay full fees via the deferred income-contingent loan scheme FEE-HELP, the number of such students at Australian universities would triple.

FUNDING CUTS AND UNIVERSITIES' COSTS AND FINANCIAL POSITION

Universities are not-for-profit organisations. University operating margins are not profits. Any difference between revenue and expenditure in a given year is reinvested by universities in their core activities of teaching, research and community engagement.

Surpluses do not represent discretionary funds available to universities. These moneys are often committed to be spent on research or capital projects in future years. Any money that isn't so committed, is increasingly needed to meet universities' maintenance and capital costs – especially as dedicated capital funding is no longer a significant component of Commonwealth support for universities.

As UA pointed out in our submission – and in our testimony before the Committee – university operating margins have declined. In dollar terms, operating results for the whole sector fell by 20 per cent in real terms between 2009 and 2015. The margin fell from 9 per cent of revenue to less than six per cent. In 2009, three out of five universities had a surplus greater than eight per cent. By 2015, this had fallen to one in five.

It is true that some of the universities with operating losses or small surpluses are dual sector institutions that operate loss making VET activities. But there are others too, who have experienced significant financial challenges – particularly those which serve communities that face higher levels of disadvantage generally, including regional universities.

It is not true that universities can 'afford' the proposed funding cuts without negative impacts, either due to economies of scale or alleged reductions in spending on teaching.

Increases in aggregate funding for universities have resulted from historic increases in enrolment numbers. This increase in student numbers came as a result of a deliberate and bipartisan policy commitment to expand access to and participation in higher education. As explained above, there has also been a small, one-off change in per student funding to correct indexation before the current decade.

Increases in enrolments impose commensurate increases in costs. A funding cut based on a concept of economies of scale implicitly assumes that levels of resourcing per place were better than adequate before the demand-driven system came into effect. Two major reviews at 'that time' (the Bradley Review of Australian Higher Education in 2008 and the Lomax-Smith Review of Higher Education Base Funding in 2011) found that funding for university teaching was less than adequate across the board, with particular shortfalls in some disciplines.²

There is no evidence that teaching costs are declining or that universities are spending less on teaching. As the Deloitte report on the *Cost of delivery of higher education* makes clear, 2016 results cannot be compared with the results of a quite different exercise in 2011 to make judgements about trends in spending on teaching.³

In any case, 2016 figures on the share of base funding per place spent on teaching do not support the idea that universities have any more money than they need to deliver higher education. Across all levels of education, spending on teaching is equivalent to 91 per cent of base funding per place, leaving only nine per cent for the other activities and commitments that base funding has to cover.⁴

Base funding covers teaching, scholarship, a base research capacity and community engagement, and supports universities to meet costs of providing courses at an acceptable level of quality, including employment of academic staff as well as administrative support and infrastructure.

The Base Funding Review concluded that arrangements for funding infrastructure as of 2011 were not sufficient to meet universities' needs in a demand-driven system.⁵ The situation has not improved since then.

Universities have to do the best they can to fund teaching in different fields and at different levels of study within the overall funding envelope.

Universities work to make education delivery more efficient while maintaining quality, including through use of technology.

Despite assertions about 'rivers of gold' and universities' 'profitability', the Government's own data on university finances shows that the real costs of operations— including rising utility bills—has grown faster than revenue in four of the last five years. The exception (2013) saw revenue increase outstrip expenditure growth by 0.1 percentage points. Revenue growth was only 1.7 per cent, and the net positive change was only \$57 million (Figure 2).⁶

² Denise Bradley, Peter Noonan, Helen Nugent and Bill Scales 2008, *Review of Australian Higher Education Final Report*, Australian Government, Canberra, pp. 152-153; Jane Lomax-Smith, Louise Watson and Beth Webster 2011, *Higher Education Base Funding Review Final Report*, Australian Government, Canberra, pp. 34-35

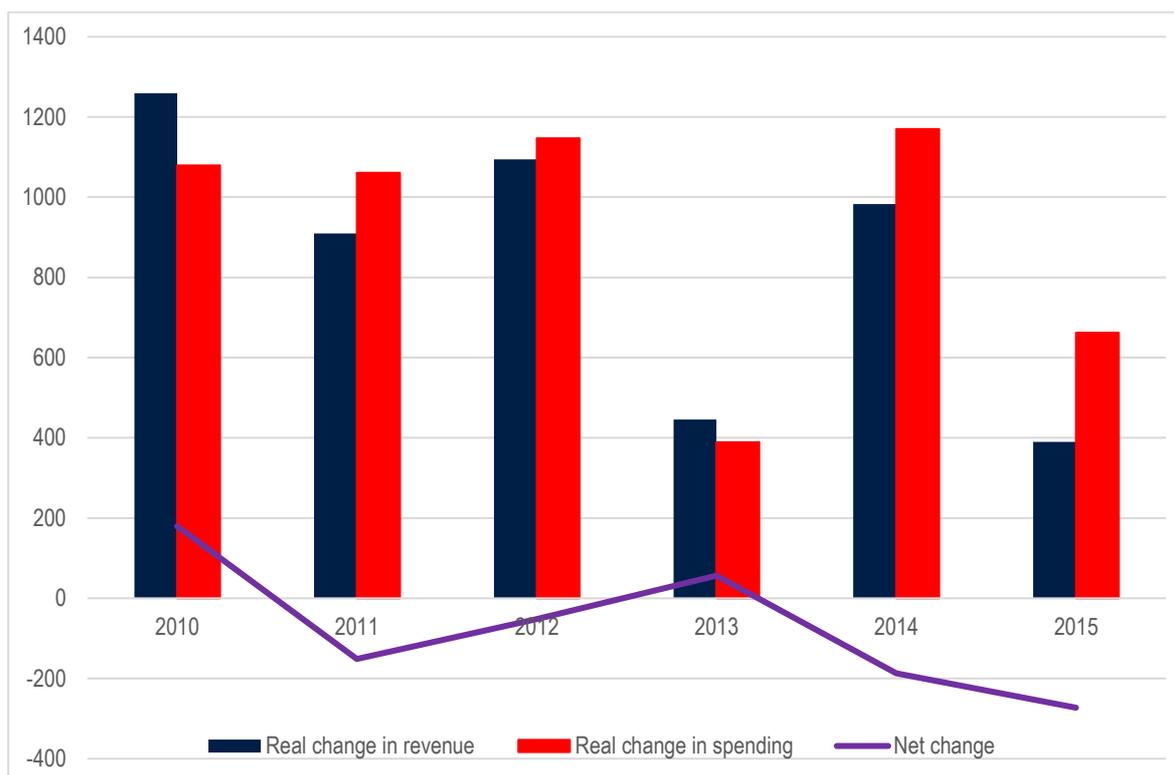
³ Deloitte Access Economics 2016, *Cost of delivery of higher education*, DET, Canberra, pp. i, x, xi, xxii

⁴ UA analysis of data provided to the 2016 costing review.

⁵ *Ibid.*, p.85-87

⁶ UA analysis of DET *Higher Education Finance Statistics*, various years

Figure 2. Real annual change in revenue and expenditure, all universities, 2010-15, (\$m)



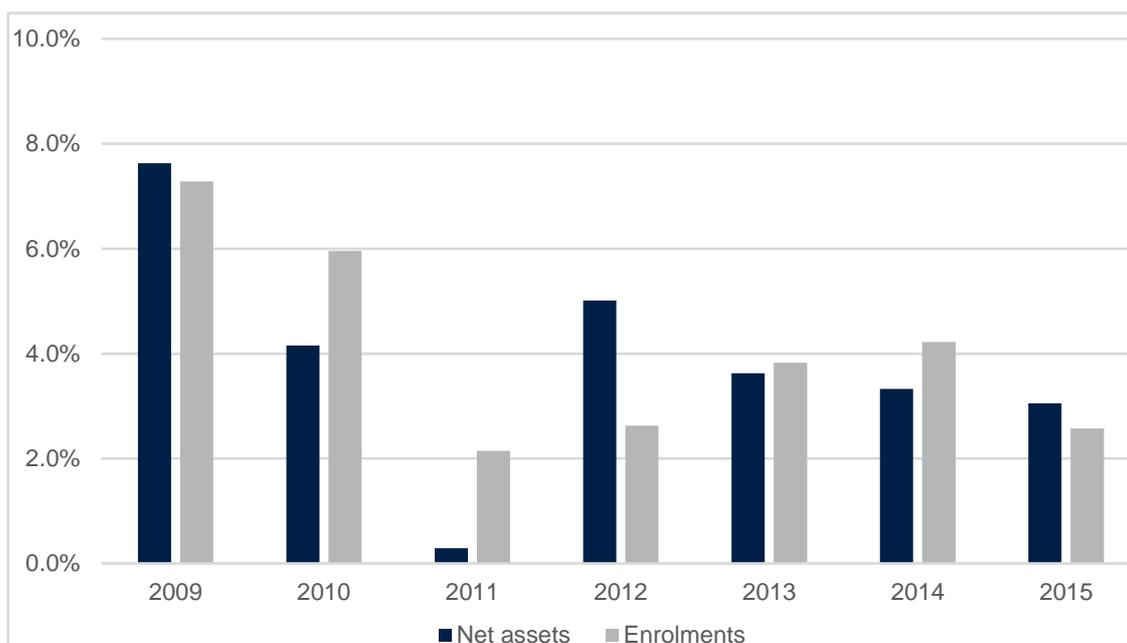
Source: DET Higher Education Finance Statistics, various years

CAPITAL COSTS AND SPENDING

Universities' net assets have increased, but growth has been consistent with increases in the size of the sector (Figure 3). Between 2008 and 2015, net assets increased by 30 per cent in real terms, averaging 3.9 per cent per year. Over the same period, growth in total enrolments was slightly higher at 32 per cent, or 4.1 per cent per year.⁷

⁷ UA analysis of DET Higher Education Finance Statistics, various years

Figure 3. Annual change in real net assets and total enrolments, 2009-15



Source: DET Higher Education Finance Statistics, various years

Universities' spending on property, plant and equipment (PPE) has grown more slowly than total expenditure or total enrolments. Spending on PPE grew quite strongly to 2012, but has declined each year since then. From 2008 to 2012, PPE grew by 43 per cent in real terms. From 2012 to 2015, it declined by 21 per cent. There is a clear relationship with the reduction in capital funding and the closing of the Education Investment Fund (EIF). PPE spending declined by 10 per cent or more in both 2013 and 2014. The decline was marginal (0.8 per cent) in 2015.

Depreciation, on the other hand, increased by 55 per cent in real terms between 2008 and 2015, at an average rate of nearly 6.5 per cent per year. By 2015, depreciation was more than \$1.9 billion, 8.2 per cent higher than the previous year.

As a result, the sector's asset replacement ratio (PPE spending over depreciation) has worsened over time. In 2008, the ratio was just over 2.25, rising to 2.5 in 2012. Since 2012, though, the asset replacement ratio has dropped to 1.64.

In 2015, there were eight universities with an asset replacement ratio of less than 1.0. A further six had a ratio of less than 1.25. Together, these universities make up more than a third of the sector. Some of these universities were running a deficit in 2015, and several others showed a modest surplus below the three per cent benchmark that is regarded as good practice in other areas of the not-for-profit sector.⁸

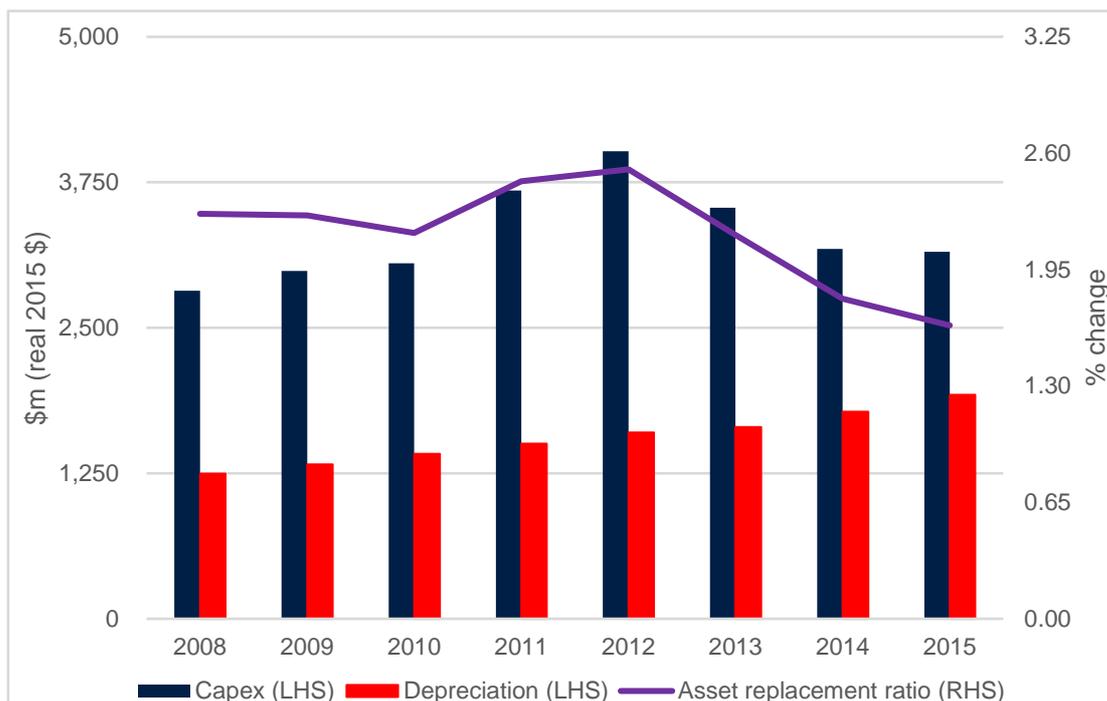
State auditors take a close interest in universities' asset (or capital) replacement ratios. A recent report on Victorian universities by the Victorian Auditor-General's Office (VAGO) outlined the reasons for this:

*'We consider the capital replacement ratio to be a long-term indicator of sustainability, given that capital replacement can be deferred in the short term. Inadequate expenditure on asset renewal and maintenance may lead to assets, including equipment and infrastructure, deteriorating to a point where they are unsuitable for use.'*⁹

⁸ UA analysis of DET Higher Education Finance Statistics, various years

⁹ VAGO 2017. *Universities: 2016 Audit Snapshot*, Victorian Government, Melbourne; p.18

Figure 4. Spending on property, plant and equipment (PPE) and depreciation, all universities, 2008-15



Source: DET Higher Education Finance Statistics, various years

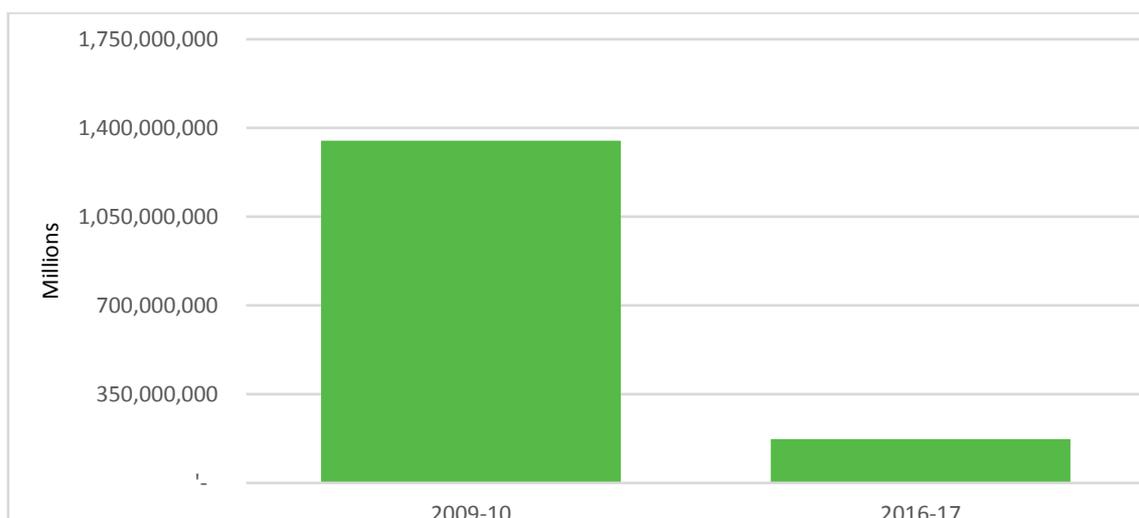
As the Queensland Audit Office has recently pointed out, a key factor in universities' increasing challenges in funding infrastructure is the drastic reduction in dedicated Commonwealth funding for capital.¹⁰

The two programs that previously funded university infrastructure are no longer active. The Capital Development Pool for special capital projects closed in 2012 and the Education Investment Fund (EIF) has not funded any projects since 2013. The remaining EIF balance (\$3.7 billion) has been earmarked for repurposing for other non-education purposes.

Figure 5 shows the decline in public investment in university infrastructure, down from almost \$1.4 billion in 2009–10 to around \$170 million in 2016–17.

¹⁰ Queensland Audit Office 2017, *Universities and Grammar Schools: 2016 – Results of Financial Audits*, www.qao.qld.gov.au; p.42;

Figure 5. Australian Government funding for teaching and research infrastructure, 2009–10 compared to 2016–17



Note: Includes funding for EIF and National Collaborative Research Infrastructure Strategy (NCRIS). The 2016–17 figures include \$150 million funding for operating NCRIS facilities.

Source: Based on the 2016-17 DET Portfolio Budget Statements; 2009-10 DEEWR Portfolio Budget Statements; 2009–10 DIISR Portfolio Budget Statements; Australian Government 2011, *Higher Education Report 2009*.

A 2015 report estimated that 33 Australian universities had \$1.87 billion worth of deferred maintenance backlog, as well as \$2.2 billion of deferred refurbishments.¹¹

A report to Government by the Higher Education Infrastructure Working Group (HEIWG), chaired by Phil Clark AM, found that in the period 2011 to 2013, universities funded about 80 per cent of their capital expenditure from their surpluses **plus depreciation**. Most of the rest of universities' capital spending was sourced from Commonwealth and State Government grants.¹²

Since the period that HEIWG examined, universities' surpluses have become smaller and Commonwealth capital grants have shrunk significantly. It therefore cannot be taken for granted that the 80:20 division in sources of capital spending described in the HEIWG report can deliver adequate infrastructure spending now or in the future. In short, both sources of capital spending are now smaller, while capital costs continue to grow.

Over 2011 to 2013, universities spent \$10.6 billion on property, plant and equipment (PPE). Commonwealth funding through EIF and one-off capital grants totalled \$1.3 billion (HEIWG estimated that another \$0.7 billion in grants supported universities' capital spending). Annual operating results across the whole sector were around \$2 billion in each of the three years. Depreciation was around \$4.5 billion over the three years.

In 2014 and 2015, on the other hand, spending on PPE was \$6.3 billion, but funding through EIF and capital grants was only \$0.3 billion. Operating results fell to \$1.9 billion in 2014 and \$1.7 billion in 2015. Depreciation was \$3.7 billion over two years. Depreciation increased at eight per cent (real) per year in 2014 and 2015.¹³

The Working Group found that the book value of buildings increased by 24 per cent over the 2011-13 triennium – significantly more than the increase in floor space (5 per cent) and total student load (8 per cent). They concluded that universities were 'improving the quality and functionality of

¹¹ Government-appointed *Higher Education Infrastructure Working Group Final Report 2015*

¹² Ibid.

¹³ UA analysis of DET *Higher Education Finance Statistics, 2014 and 2015*

infrastructure rather than simply expanding floor space to accommodate more students or underpin growth in research activity'.¹⁴

The Working Group concluded that the important policy consideration is to 'enable universities to generate sufficient operating surpluses to provide the resources for investment in infrastructure'.¹⁵

It also notes however that since the Government closed EIF in 2014, there has been no dedicated funding for infrastructure for 'the building fabric necessary to accommodate teaching and research activity'.¹⁶

Recommendation 5 of the report is that Government develop a long-term plan for funding for transformative infrastructure, based on analysis of the impact of the Higher Education Endowment Fund (HEEF) and the Education Investment Fund (EIF) for universities and the nation. The new plan would cover both teaching and research and have 'co-investment and collaboration as prerequisites'.¹⁷

RECOMMENDATIONS

UA has no additional recommendations, and reminds the Committee of the recommendations from our earlier submission.

Recommendations

That the Committee, at a minimum:

1. oppose the proposed efficiency dividend;
2. oppose the changes that affect student affordability;
3. remove provisions for performance funding so they can be properly considered, scrutinised and analysed through a considered and consultative process;
4. ensure feasible timeframes for smooth implementation; and
5. consider the positive elements of the Bill and how they might best be delivered:
 - a. extension of the demand-driven system to sub-Bachelor places; and
 - b. legislative protection for HEPPP and changes to the program.

¹⁴ HEIWG report, p.17

¹⁵ *ibid*

¹⁶ *Ibid.*, p.55

¹⁷ *Ibid.*, p.xi