Research Update:

University Of Nottingham 'A+' Rating Affirmed; Outlook Stable

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Overview

- We consider that the management of U.K.-based University of Nottingham (Nottingham) has strong control over the cost base, such that operating margins have remained relatively strong, despite inflationary cost pressures.
- In our view, demand for the university's provision of higher education will remain solid, supporting steady revenue growth over the next two to three years.
- We consider that Nottingham's access to undrawn credit facilities mitigates the fact it holds relatively low levels of cash compared with operating costs.
- We affirmed our 'A+' long-term issuer credit rating on Nottingham. The outlook is stable.

Rating Action

On June 27, 2023, S&P Global Ratings affirmed its 'A+' long-term issuer credit rating on Nottingham. The outlook is stable.

Outlook

The stable outlook reflects our expectation that Nottingham's prudent management and financial buffers should prevent a deterioration in financial performance and ease pressure on the university's financial resources, despite inflationary pressures on costs. It also reflects our expectation that Nottingham will manage its ongoing investment program without significantly building up debt.

Downside scenario

We could lower the rating on Nottingham if the university's key indicators deteriorate materially. This could happen if, for instance, operating margins weaken because of stagnating revenue growth and materially higher costs linked to high inflation and unsuccessful cost control by management, the university's cash levels are depleted, and debt to fund its investment program builds up.

Upside scenario

We could raise the rating on Nottingham if a stronger financial performance supports a faster accumulation of its intrinsic cash position, such that the university structurally strengthens its financial resources without a corresponding increase in debt. More specifically, we could upgrade Nottingham if the university's financial resources exceed 60% of operating expenditure, while debt remains stable.

Rationale

The 'A+' rating is underpinned by our view that demand for Nottingham's provision of higher education will remain solid, supporting steady revenue growth over the next two to three years. It also reflects our view that management has strong control over the cost base, such that its operating margins have remained relatively strong. This supports our view that management has solid expertise and experience and operates the university effectively. We consider that Nottingham's access to undrawn credit facilities mitigates the fact that it holds relatively low levels of cash. The debt service metrics remain very strong.

Enterprise profile: Solid demand and prudent cost management should continue to support Nottingham's credit metrics

Our rating on Nottingham is supported by our assessment of low industry risk for the higher education sector, which is anticyclical in nature and has high barriers to entry. We consider that Nottingham's strong reputation as a Russell Group University will continue to support strong student demand.

Nottingham has increased the number of full-time equivalent students for six consecutive years, from about 29,100 in the fiscal year ending July 2016 to close to 35,800 in fiscal 2023. We understand Nottingham's focus will shift from nominal growth in student numbers to the student experience in each of its six campuses, including investments in estates and student wellbeing. Nottingham is also investing in digital offerings for students, reflecting the changing needs of students at home and overseas. In 2021, the university acquired the Castle Meadow campus in Nottingham city center. It plans to make significant investments in this estate over the coming years, with links to law and auditing firms that will have their offices on campus. We think that this would support the university's aim to attract an increasing number of postgraduate students, which should support revenue growth going forward.

Nottingham's admission remains selective. On average, the university made offers to only 67% of applicants in the past five years. We note the university's QS World University Rankings have declined since 2019. While we understand Nottingham will try to reverse this trend, so far, it has not had a material effect on student demand. We expect demand will remain strong, evidenced by a still solid estimated 4% growth in undergraduate applications in fiscal 2023.

We expect management will continue its proactive approach to managing its revenue and cost base, as evidenced by the measures implemented during the pandemic. We understand Nottingham continues to strive to streamline the university's cost base, reducing inefficiencies in its estate and mitigating the impact from inflationary cost pressures. This has supported the university's financial performance over the past two years. While high inflation will weigh on the university's cost base, we expect continued cost control will help its trajectory, despite challenges in the sector, such that the university's operating margins remain positive.

Financial profile: Financial performance will remain stable and debt profile will remain strong

Its strong performance, available cash, and uncommitted credit facilities will continue to support the university's solid liquidity position. In 2021, the university acquired the Castle Meadow campus in Nottingham city center. We think Nottingham will partly fund investments in Castle Meadow and other projects with existing financial resources, which may reduce cash levels. We, therefore, forecast total resources, through our forecast period to July 31, 2026, will continue to cover less than 30% of operating expenditure.

Nottingham's debt burden remains stable and very low, compared with many peers, with a maximum annual debt service of an estimated 1.6x in the current fiscal 2023, marginally below last year's level. At the same time, we assess the university's resources-to-debt ratio will remain above 110% on a five-year average. Nottingham's debt comprises a £100 million private placement, which we include at its face value. To be consistent with other rated peers, we add to this debt what S&P Global Ratings considers debt-like obligations linked to Nottingham's partnership with University Property Partnerships (UPP).

While the university may debt-fund some of its capital expenditure going forward, we think it would use some of its available cash and currently do not expect a material increase in debt in the short term. Furthermore, should the university need to raise debt to fund larger investment projects, we consider that Nottingham has relatively solid headroom to do so without negatively affecting our assessment.

Nottingham has two main pension schemes, namely Universities Superannuation Scheme (USS) and Contributory Pension and Assurance Scheme (CPAS). Nottingham's pension contributions to USS have increased following the conclusion of the 2020 valuation. The next valuation has concluded, but the outcome has yet to be published. However, we understand it is likely that the deficit has been reversed into a surplus, which would alleviate pressure on universities' pension contributions. We further understand that the FRS102 deficit in CPAS is managed with current and future contributions, and that the scheme remains largely funded.

Government-related entity analysis

We assess the likelihood that the U.K. government, through the Office for Students, would provide extraordinary support to Nottingham in the event of financial distress as moderately high. This is neutral to the rating. Our view is based on our view that Nottingham:

- Plays an important role for the U.K. government, given the significance and profile of U.K. higher education policy; and
- Has a strong link with the U.K. government, demonstrated by its track record of providing support to the sector and ongoing regulatory involvement.

Environmental, Social, And Governance

We analyzed Nottingham's risks related to environmental, social, and governance factors and acknowledge elevated social risks. We think U.K. universities are exposed to risks associated with an ongoing dispute regarding pay, working conditions, and pensions, which may result in occasional disruptions to teaching processes.

Selected Indicators

Table 1

University of Nottingham--Key statistics

	--Financial year end July 31--				
(Mil. £)	**2021a**	**2022a**	**2023bc**	**2024bc**	**2025bc**
Enterprise profile					
Full-time equivalent enrolment (no.)	33,439	35,430	35,031	--	--
Undergraduates selectivity rate (%)	75.3	72.2	68.2	--	--
Undergraduates as a % of total FTE enrolment	80.5	78.5	77.5	--	--
Retention rate (%)	96.5	96.5	96.5	--	--
Graduation rates (five years) (%)	95.6	95.6	95.6	--	--
Financial profile					
Operating revenue	696.1	801.7	813.0	848.9	890.9
Adjusted operating expense†‡	669.3	743.6	787.5	824.6	853.8
Net adjusted operating margin (%)*	4.0	7.8	3.2	2.9	4.3
Student dependence (%)	55.7	54.1	54.2	54.9	54.9
Research dependence (%)	16.5	16.4	16.5	16.5	17.7
Government grant dependence (%)	14.7	13.5	13.9	13.1	12.3
Endowment and investment income dependence (%)	0.6	0.7	0.4	0.1	0.1
Adjusted outstanding debt	186.9	187.8	187.5	187.5	187.5
Maximum annual debt service/total operating expense (%)	1.9	1.7	1.6	1.6	1.5
Cash and investments to adjusted operating expenses (%)	28.8	28.3	26.1	24.1	27.9
Cash and investments to total debt (%)§	103.0	112.2	109.8	106.1	126.9

*Net income/Operating expense. §Does not include undrawn revolving credit facilities as an available resource. ‡Adjusted for pension provision movements. a--Actual. bc--Base case reflects S&P Global Ratings' expectations of the most likely scenario.

Ratings Score Snapshot

Table 2

University of Nottingham--Ratings score snapshot

Industry risk score	2
Economic fundamentals score	1
Market position score	2
Management & governance score	2
Enterprise risk profile score	**2**
Financial performance score	2
Financial resources score	3
Debt and contingent liabilities score	3
Financial risk profile score	**3**
Stand-alone credit profile	**a+**
Issuer credit rating	**A+**

Related Criteria

- Criteria | Governments | General: Global Not-For-Profit Education Providers, April 24, 2023
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010

Related Research

- United Kingdom Outlook Revised To Stable From Negative On Moderating Fiscal Risks; 'AA/A-1+' Ratings Affirmed, April 21, 2023
- Outlook For Global Not-For-Profit Higher Education: Credit Quality Continues To Diverge, Jan. 18, 2023
- Inflation To Erode The Performance Of U.K. Public Finance Sectors, Nov. 29, 2022
- Australia, Canada, Mexico, And U.K. Universities Medians: Fiscal 2021 Credit Trends Turned Positive Despite Challenges, Oct. 20, 2022

Ratings List

Ratings Affirmed	
Nottingham (University of)	
Issuer Credit Rating	A+/Stable/--