Research Update:

U.K.-Based University of Nottingham 'A+' Rating Affirmed; Outlook Stable

June 16, 2021

Overview

- The COVID-19 pandemic weakened the University of Nottingham's (Nottingham's) financial performance, but less severely than we anticipated.

- Nottingham's strong reputation continues to support student demand and enrolment, which continued to grow in financial year (FY) ending July 31, 2021, but with an increased proportion of domestic undergraduates.

- We affirmed our 'A+' long-term issuer credit rating on Nottingham. The outlook remains stable.

Rating Action


Outlook

The stable outlook indicates that Nottingham will continue to prudently manage the pandemic-induced budgetary pressures. This should limit a deterioration in financial performance and ease pressure on Nottingham's financial resources.

Downside scenario

We could lower the rating on Nottingham if the university's income from tuition fees and other services does not recover in the medium term, or if the university eases its cost control. This could lead to S&P Global Ratings-adjusted operating margins weakening on a sustained basis, together with a depletion of cash levels or additional debt intake.

Upside scenario
We could raise the rating on Nottingham if a stronger financial performance supports a build-up of its intrinsic cash position, such that the university structurally strengthens its financial resources position without a corresponding increase in debt. The ratings could improve if the university's financial resources go above 35% of operating expenditure, while holding debt stable.

**Rationale**

The affirmation reflects our view that Nottingham continues to manage the pandemic prudently. Given the university's strong reputation, student enrolment remained steady through FY2021, albeit with a larger proportion of domestic undergraduates. This is a change compared with previous years and could somewhat tighten margins if sustained over time, because U.K. undergraduates pay lower tuition fees than postgraduate and international students. While we project total income to be lower in 2021 compared with 2020, the university has implemented cost-containment measures on its operating expenses (opex) base and paused some of its capital program. This is intended to limit the negative impact on Nottingham's adjusted operating margins and financial resources caused by pandemic-induced disruption to activities.

Our rating on Nottingham is supported by our assessment of low industry risk for those operating in the higher education sector, which is anticyclical in nature and has high barriers to entry. With COVID-19 weakening the labor market globally and restricting travel, we expect an increase in demand for universities as people look to learn new skills or improve existing ones.

Nottingham’s strong reputation as a Russell Group University supported student demand through the pandemic, as demonstrated by its selectivity and strong enrolment. Nottingham increased the number of full-time equivalent (FTE) students for five consecutive years, from about 29,100 in FY2016 to close to 33,700 in FY2021. Nottingham’s admission is selective; on average, the university made offers to only 66% of applicants in the past five years. We understand that applications remain high despite the pandemic-related uncertainty, as students still plan to enroll. We view as a positive that Nottingham was also able to increase its tuition fee per FTE over recent years (to £11,800 in 2020 from about £10,500 in 2017), despite U.K. undergraduate students' fees being capped at £9,250 per year. We estimate a drop in FY2021, however, as the university has enrolled more domestic and undergraduate students, who pay relatively lower fees compared with international and postgraduate students.

Nottingham’s international operations could mitigate the effects of reduced travel. Campuses in China and Malaysia, which award Nottingham degrees, could be used to offset international enrolment in the U.K. if travel restrictions affect enrolment.

We view positively management’s proactive approach to the challenges the university faced since the pandemic's onset. Plans were put in place to mitigate the income loss and any additional costs. Nottingham has started to streamline the university’s cost base, reducing inefficiencies in its estate. Through FY2020 Nottingham also launched a voluntary redundancy scheme that should yield medium-term staff cost savings, helping the university to manage the multi-year impact of the pandemic. The university paused nonessential parts of its capital expenditure (capex) plan, which also supported its cash balances.

Overall, we expect the net impact on the university's financial performance to be negative compared with historical figures, albeit less severe than previously expected. For FY2021, we forecast that income will drop by about £30 million compared with the prior year, mainly because of lower tuition fee income and reduced accommodation, catering, and other commercial income. Lower staff and other operating costs should counterbalance this, however. On a three-year weighted basis, we expect S&P Global Ratings-adjusted operating margins to stand at 1.6% of operating expenses. We think that the pandemic-induced loss of income will be temporary in
nature, supporting medium-term improvement in Nottingham's financial performance.

Nottingham's £100 million private placement issued in FY2020, together with the abovementioned capex cuts, continue to support the university's solid liquidity position. We understand the university used some of the placement’s proceeds to repay its outstanding debt. Combined with three undrawn liquidity facilities, we now expect total resources of about £220 million in FY2021. This would result in available resources of about 20% of opex on a three-year weighted average.

Nottingham's debt levels remain lower than those of peers. Debt now largely comprises the £100 million private placement. Nottingham's decision to issue a private placement resulted in a stronger financial resources-to-debt ratio. Historically, Nottingham held little cash, preferring to use revolving credit facilities (RCFs), which are not included in our calculation. As a result, resources were structurally below 10% of debt. Including the intrinsic cash buffer the university built on the back of the private placement and capex cuts, however, resources should average about 50% of debt over FY2020 and FY2021.

At the same time, Nottingham's maximum annual debt service burden remains low, below 2%, which is the lowest compared with rated peers.

Nottingham has two main pension schemes: Universities Superannuation Scheme (USS) and Contributory Pension and Assurance Scheme (CPAS). We expect that Nottingham’s pension contributions to the USS will increase, helping to reduce the scheme’s deficit. We further understand that the FRS102 deficit in CPAS is addressed with current and future contributions, and that the scheme remains more than 60% funded to date.

**Moderately high likelihood of extraordinary government support**

While neutral for the rating, we see a moderately high likelihood that the U.K. government, through the Office for Students (OfS), would provide extraordinary support in financial distress. Our view of a moderately high likelihood of extraordinary government support is based on our assessment of Nottingham’s:

- Important role for the U.K. government, given the significance and profile of U.K. higher education policy; and
- Strong link with the U.K. government, demonstrated by the government’s track record of providing support to the sector and ongoing regulatory involvement.

**Environmental, social, and governance factors**

In our view, higher-education entities face elevated social risk due to uncertainty over the duration of the pandemic and its effect on enrolment levels, campus activities, and mode of instruction in 2021 and beyond. We view the risks posed by COVID-19 to public health and safety as a social risk under our environmental, social, and governance factors. We believe Nottingham's environmental and governance risks are in line with our view of the sector as a whole.

S&P Global Ratings believes there remains high, albeit moderating, uncertainty about the evolution of the coronavirus pandemic and its economic effects. Vaccine production is ramping up and rollouts are gathering pace around the world. Widespread immunization, which will help pave the way for a return to more normal levels of social and economic activity, looks to be achievable by most developed economies by the end of the third quarter. However, some emerging markets may only be able to achieve widespread immunization by year-end or later. We use these assumptions about vaccine timing in assessing the economic and credit implications associated
with the pandemic (see our research here: www.spglobal.com/ratings). As the situation evolves, we will update our assumptions and estimates accordingly.

Key Statistics

University of Nottingham--Selected Indicators

<table>
<thead>
<tr>
<th>(Mil. £)</th>
<th>2021e</th>
<th>2020a</th>
<th>2019a</th>
<th>2018a</th>
<th>2017a</th>
</tr>
</thead>
<tbody>
<tr>
<td>Enterprise Profile</td>
<td></td>
<td></td>
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<tr>
<td>Full-time equivalent enrolment (no.)</td>
<td>33,715</td>
<td>32,885</td>
<td>32,323</td>
<td>30,476</td>
<td>29,492</td>
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<tr>
<td>Selectivity rate (%)</td>
<td>66.5</td>
<td>68.5</td>
<td>68.6</td>
<td>65.6</td>
<td>62.7</td>
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<tr>
<td>Undergraduates as a % of total enrolment</td>
<td>70.0</td>
<td>55.6</td>
<td>56.0</td>
<td>56.1</td>
<td>57.4</td>
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<td>Retention rate (%)</td>
<td>N.A.</td>
<td>93.4</td>
<td>93.4</td>
<td>93.9</td>
<td>93.9</td>
</tr>
<tr>
<td>Graduation rates (five years) (%)</td>
<td>N.A.</td>
<td>95.6</td>
<td>95.5</td>
<td>95.9</td>
<td>95.6</td>
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<tr>
<td>Financial profile</td>
<td></td>
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<td></td>
</tr>
<tr>
<td>Adjusted operating revenue</td>
<td>682.6</td>
<td>710.4</td>
<td>701.2</td>
<td>664.0</td>
<td>646.1</td>
</tr>
<tr>
<td>Adjusted operating expense</td>
<td>678.9</td>
<td>701.5</td>
<td>682.0</td>
<td>644.2</td>
<td>621.5</td>
</tr>
<tr>
<td>Net adjusted operating margin (%)*</td>
<td>0.5</td>
<td>1.3</td>
<td>2.8</td>
<td>3.1</td>
<td>4.0</td>
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<tr>
<td>Student dependence (%)</td>
<td>55.0</td>
<td>54.8</td>
<td>50.9</td>
<td>50.3</td>
<td>47.9</td>
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<td>Research dependence (%)</td>
<td>16.9</td>
<td>14.8</td>
<td>17.7</td>
<td>18.1</td>
<td>19.1</td>
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<td>Government grant dependence (%)</td>
<td>14.8</td>
<td>13.9</td>
<td>13.0</td>
<td>13.6</td>
<td>13.9</td>
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<tr>
<td>Endowment and investment income dependence (%)</td>
<td>0.3</td>
<td>1.2</td>
<td>0.6</td>
<td>1.1</td>
<td>1.7</td>
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<tr>
<td>Adjusted outstanding debt</td>
<td>100.5</td>
<td>100.5</td>
<td>73.7</td>
<td>79.7</td>
<td>79.9</td>
</tr>
<tr>
<td>Maximum annual debt service/total operating expense (%)</td>
<td>1.0</td>
<td>1.0</td>
<td>0.7</td>
<td>0.8</td>
<td>0.9</td>
</tr>
<tr>
<td>Available resources to adjusted operating expenses (%)</td>
<td>32.5</td>
<td>19.3</td>
<td>15.1</td>
<td>15.7</td>
<td>5.2</td>
</tr>
<tr>
<td>Available resources to total debt (%)†</td>
<td>65.4</td>
<td>40.0</td>
<td>8.4</td>
<td>7.5</td>
<td>7.5</td>
</tr>
</tbody>
</table>

*Net income/Adjusted operating expense; †Does not include revolving credit facilities as an available resource. a--Actual. e--Estimate. N.A.--Not available.

Related Criteria

- General Criteria: Methodology: Not-For-Profit Public And Private Colleges And Universities, Jan. 6, 2016
- 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
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Related Research
- United Kingdom 'AA/A-1+' Ratings Affirmed; Outlook Stable, April 23, 2021
- Outlook For Global Not-For-Profit Higher Education: Empty Chairs At Empty Tables, Jan. 20, 2021
- COVID-19 Means International Students Could Give English Universities A Pass, April 9, 2020

Ratings List

Ratings Affirmed

Nottingham (University of)
Issuer Credit Rating_A+/Stable/--

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352 Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.
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