Report
by the Comptroller
and Auditor General

**Department for Education, HM Treasury,
UK Government Investments**

The sale of student loans

HC 1385 SESSION 2017–2019 20 JULY 2018

Key facts

£3.5bn
face value of the loans sold before taking account of any impairments

£1.7bn
proceeds to the government from the sale of student loans and reduction in public sector net debt

411,000
approximate number of borrowers whose loans have been included in the sale

£43 billion	face value of all English student loans issued before 2012 and identified for sale as of March 2017
£12 billion	government's planned proceeds from the initial wave of student loan sales between 2017 and 2022
£0.9 billion	accounting loss on the Department for Education's accounts resulting from the sale
£0.6 billion	estimated net loss of future receipts from student loan repayments as a result of the sale
£102 billion	face value of all English student loans as of March 2018
£473 billion	government forecasts for the face value of all student loans as of March 2049 in 2018-19 values
55%–60%	government's long-term estimate of the value of loans that will be repaid

Summary

Introduction

1 Since 1990 the government has allowed universities and higher education providers to charge fees to students. Over time it has also replaced grant-based support with a system of student loans. The terms of these loans have changed with time and student loan repayments are now based on the level of income students earn after leaving higher education.

2 Government's student loan portfolio is expanding rapidly. The face value of all outstanding student loans rose from £89 billion in March 2017 to £102 billion in March 2018. The value of outstanding student loans is expected to reach £473 billion by March 2049. Government's long-term estimate is that 55–60% of the loan value will be repaid.

3 In 2013 the government decided to sell a portion of the student loans issued before 2012. At March 2017, the face value of all outstanding loans issued before 2012 was £43 billion. It plans to complete a programme of sales between 2017 and 2022, and to raise around £12 billion. In December 2017 the government completed its first sale of loans to private investors, consisting of most loans that entered repayment between 2002 and 2006.

4 Government had three objectives for the sale:

- to reduce public sector net debt;
- to ensure there was no detrimental impact on borrowers; and
- to achieve value for money.

5 The Department for Education (the Department) sets student loan policies and oversees the administration and collection of student loans by the Student Loans Company and HM Revenue & Customs. HM Treasury identified the assets as available for sale and UK Government Investments (UKGI), a company wholly owned by HM Treasury, managed the sale and acted as the Department's transaction adviser.

Study scope

6 In this report we consider the value for money of this sale of student loans and set out:

- the main outcomes of the sale (Part One);
- how government assessed value for money in deciding to sell (Part Two); and
- how UKGI managed the sale (Part Three).

Key findings

Outcomes of the sale

7 The sale of student loans raised £1.7 billion. The government sold the loans of over 400,000 borrowers that became eligible for repayment between 2002 and 2006. These loans had an outstanding face value – total loans including accrued interest and deducting repayments already made – of £3.5 billion repayable up to 2052 (paragraphs 1.13, 1.14 and Figure 4).

8 Government received less than half the outstanding value of the student loans. The government received 48p for every £1 of loans sold which exceeded its retention value. When issuing loans, government does not expect to receive all the money back. It estimates that for loans issued before 2012, only 65%–70% by value will be repaid. Loans in the 2017 sale are expected to have even lower repayment rates because they are older loans and nearly half had been repaid in full by the time of the sale. Investors also require compensation for taking on risk over future payments due to changes in borrowers' earnings (paragraphs 1.14, 1.15 and Figure 10).

9 The sale of student loans does not affect borrowers. HM Revenue & Customs, the Student Loans Company and UKGI will continue to administer loans and collect repayments on current terms. Investors will have no contact with borrowers and no influence over repayment rates. The government has in effect sold an uncertain stream of future repayments in exchange for a lump sum. If government chooses to change repayment terms in future or makes specific mistakes in administering the loans it will need to compensate investors (paragraphs 1.16 to 1.21).

10 The sale reduces a headline measure of public debt. By selling student loans the government reduces its headline debt measure of public sector net debt (PSND). This measure does not take account of the loss of future receipts from student loan repayments which we estimate at around £604 million. Selling loans for cash therefore reduces PSND by the full sale amount of £1.7 billion (paragraphs 1.22 to 1.27, 2.2 to 2.5, 2.17 Figure 7, Figure 10 and Appendix Three).

11 Other measures of the sale's impact show a different effect on government's financial position. For measures which take account of future repayments, the sale of student loans crystallises impairments against outstanding loans. For example, a measure of public sector net financial liabilities (PSNFL) increased by £1.8 billion as a result of the sale. However, PSNFL does not take into account that, when the Department issued the loans, it did not expect them to be fully repaid. This subsidy explains some of the £1.8 billion loss. The Department previously recorded the loans at £2.6 billion in its balance sheet, at a discount to face value but more than the sale value of £1.7 billion. It has therefore had to record a loss of £0.9 billion in its 2017-18 accounts. While each measure has its limitations, HM Treasury's objectives for the sale only focused on PSND (paragraphs 1.25 to 1.27, Figure 7 and Appendix Three).

Analysis supporting the decision to sell

12 Government aims to retain only those assets that are required to meet its public service obligations. This sale falls into a wider programme of asset sales, announced in the December 2013 Autumn Statement and 2015 Budget, designed to reduce PSND. Government's current plan is to achieve sale proceeds of around £12 billion by 2022 from student loans issued to borrowers starting university between 1998 and 2012 before considering whether to sell the remaining student loans. As in any asset sale, HM Treasury expects the asset-owning department to assess whether a sale should occur on value-for-money grounds (paragraphs 1.10, 1.24, 2.3 and Figure 13).

13 The Department was accountable for assessing the value for money of the sale; HM Treasury set the value-for-money criteria. In 2007, HM Treasury wrote to the then Department for Education & Skills, setting out the value-for-money criteria to be applied to a sale of student loans. HM Treasury subsequently agreed the sale objectives with the Department and worked with it to understand the impact of different sales options. As with other asset sales, HM Treasury's *Green Book* set several key assumptions used to calculate the monetary value of retaining the student loans, which in turn drives the Department's value-for-money assessment (paragraphs 1.8, 1.9, 2.2 to 2.5, Figure 3 and Figure 8).

14 The way that government assesses value for money is sensitive to discount rates used. In determining the loans' retention value HM Treasury requires future cash flows to be discounted by the Social Time Preference Rate, to reflect that money today is worth more than money in the future. This rate is currently higher than market interest rates (which affect how investors discount future cash flows) and so selling the assets looks attractive for government. In determining the retention value HM Treasury also discounts for inflation more heavily than, for example, potential investors may do. If market interest rates rise by a few percentage points this could mean that market valuations of student loans fall below government's retention value, preventing completion of the planned programme of student loan sales (paragraphs 2.4, 2.6 to 2.15, Figure 9 and Figure 10).

Managing the transaction

15 **Once the decision to sell had been made UKGI took a clear approach to identifying and selecting options.** It reviewed sale options against HM Treasury's objectives, including ensuring that the accounting treatment for the sale removed student loans from the government's balance sheet. Some options which did not 'declassify' the asset were estimated to achieve a higher transaction value but left risk with the government. These options were discarded to achieve the declassification objective. A whole loan sale and a securitisation were shortlisted but their associated costs not evaluated. UKGI selected a securitisation process, which is a familiar structure for investors and maximises potential demand (paragraphs 3.2 to 3.11 and Figure 11 to Figure 14).

16 **UKGI ran the sale process effectively and met the tests HM Treasury set for the sale process.** UKGI conducted extensive market testing to ensure there was an appetite for securitised student loans. It provided potential buyers with information to understand the underlying assets and price them efficiently, soliciting investor interest from just under 200 investors, and holding more than 60 face-to-face meetings. Excess demand in the pricing phase allowed UKGI to increase the final sale price from its initial estimates (paragraphs 3.12 to 3.21, Figure 3, Figure 15 and Figure 16).

17 **UKGI developed a model to help investors value the loans.** The model used for the Department's accounts forecasts cash flows for a population with a constant flow of new borrowers but is not designed to predict repayment rates for a closed portfolio of loans with a fixed group of borrowers. UKGI, therefore, provided investors with a bespoke model, developed in conjunction with the Government Actuary's Department, to help investors estimate future cash flows. Comparing this bespoke model against historic data suggests it performs within the tolerances the Department expects but fluctuates, highlighting the uncertainty in estimating future cash flows (paragraphs 3.14 to 3.18, Figure 17 and Appendix Four).

18 **UKGI sold the student loans at its upper estimate of what the market would pay.** The government's retention value is not an indicator of what the market will pay for an asset. Following a previous National Audit Office recommendation, UKGI also estimated a market value of the loans. The sale price of £1.7 billion was broadly in line with UKGI's estimate of market value (paragraphs 2.6 to 2.15, Figure 9 and Appendix Four).

19 **The ultimate value of student loans is uncertain.** If the forecasts in UKGI's model are correct, for example on macroeconomic and repayment assumptions, the sale price suggests investors collectively will receive a yield to maturity of around 6.5% per year on their investment. If UKGI's model underestimates actual cash flows then investors' returns will increase, likewise if new information reduces investors' perception of risk, the value of the loans may increase in the secondary market. The reverse is also true. Only time will tell how the real cash flows compare to those forecast and consequently the buyers' investment return (paragraphs 3.14 to 3.21, Figure 9 and Appendix Four).

Conclusion on value for money

20 The sale of student loans was conducted under government's policy to sell assets where there is no policy reason for continued public ownership. In this context UKGI prepared well for the sale, creating a structure which encouraged investor interest and maintained competitive tension during the process. The value of the loans is subject to a high level of uncertainty, but UKGI's estimates of what investors would pay were reasonable, and the sale achieved prices at the upper end of these estimates. In terms of the preparation, process and proceeds of the transaction itself UKGI has achieved value for money.

21 But the sale of student loans also shows limitations in the way that government assesses value for money and measures for the costs of student loans over time. The Department uses one set of assumptions for the cost of student loans when they are added to government's balance sheet, and HM Treasury uses another set of assumptions in support of its decision to sell them. This offers two different ways of calculating the subsidy to, and value of, its rapidly growing student loan portfolio. The two approaches give different answers which risks government: not knowing with enough certainty the cost to the taxpayer of student loans when they are issued; and of selling assets too cheaply relative to their long-term value despite achieving its objective of reducing public sector net debt.

Recommendations

22 For any asset which the government intends to dispose of we expect to see the use of multiple measures to assess the impact on the government's current and future financial liabilities and a fuller consideration of the financial impact of the sale on government.

23 For future sales of student loans we would expect the Department and UKGI to:

a **Include details of the timing and sizing of the remaining programme in the transaction approval documents** to provide transparency on the future plans and their impact;

b **Reassess disposal options for every sale**, and include considerations about the transaction and ongoing costs related to the alternatives; and

c **Refine the value-for-money framework applied to calculate the valuations as new data on this novel asset class emerges**.