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How do institutions of education finance their property (buildings and grounds)

1. Introduction and conclusion

1.1. Purpose and conclusion

1. This report concerns whether the Danish Ministry of Higher Education and Science and the Danish Ministry of Children and Education ensure that government-funded independent institutions of education take due financial considerations into account when financing real-estate property of which they have ownership.

2. The study comprises 253 institutions of education that own property, and are therefore permitted to seek private financing. The institutions may take out any type of loan. However, it does appear from the legislation governing the different types of educational institutions like, for instance, universities and technical colleges, that the boards of the institutions are required to administer the funds to the benefit of the objectives set for the institutions.

3. Government-funded independent institutions of education are legally separate from the state, and therefore the minister has no powers of direction over the independent institutions of education, which have their own boards of directors. However, the Ministry of Higher Education and Science and the Ministry of Children and Education monitor the institutions and, in certain circumstances, they can remove the board and management of an institution. The fact that the institutions of education are legally separate from the state means that in principle they can go bankrupt without the state becoming liable to the creditors of the institutions. So far, however, the state has provided special grants or liquidity loans to institutions with liquidity shortage. The state has therefore sustained a loss, when the institutions have mismanaged and run into financial difficulties.

4. Since 2011, several institutions of education under the Ministry of Children and Education have asked the ministry for liquidity loans and/or special grants, because they have experienced an acute shortage of liquidity. In the period from 2011 to 2019, the Ministry of Children and Education has provided 18 liquidity loans and 7 special grants to 10 different institutions. All loans and grants have been provided from a finance act account that permits the ministry to provide financial support to institutions that find themselves in particularly difficult financial circumstances. According to the Ministry of Children and Education, the institutions must have exhausted all possibilities of obtaining liquidity elsewhere, before the ministry can step in and provide a grant.

Government-funded independent institutions

Government-funded independent institutions are placed outside the ministerial hierarchy, and the responsibility for the overall activities of the individual institutions lies with a board. (Consolidated Budgeting Guidance, item 2.11.1.).

Institutions of education owning property

These institutions may have control of both their own buildings, leased buildings and leaseholds. Institutions of education that do not own property primarily lease buildings and office space through an arrangement set up by the government.

Box 1 shows an example of how Svendborg Erhvervsskole & Gymnasier (institution offering college and high school education) due to overcapacity and overly optimistic forecasts of enrolment rates, ran into severe financial difficulties.

Box 1

Example of an institution in financial distress

In the early noughties, the board of Svendborg Erhvervsskole & Gymnasier decided to expand the school's space. The expansion was loan financed, and part of the loan was supplemented with an interest swap agreement. However, the prognosis of enrolment, which, among other factors, served as the basis for the expansion, turned out to be overly optimistic. Since the expansion, the school has therefore had considerable overcapacity and found itself in deep financial difficulties. In the period from 2011 to 2017, the Ministry of Children and Education granted the school 4 liquidity loans of in total DKK 28.4 million. The school has informed Rigsrevisionen that the school's biggest problem is debt, and that its income in the period from 2007 to 2019, instead of going to employment of more teachers, purchase of teaching materials, etc., has been spent on payment of interest and installments on loans concerning empty buildings and grounds. Special grants and liquidity loans provided by the state compensated for the institution's mismanagement, and prevented the school from potential bankruptcy.

Source: Rigsrevisionen based on information provided by the Ministry of Children and Education.

In addition to Svendborg Erhvervsskole & Gymnasier, 9 other institutions of education have received liquidity loans and/or special grants from the Ministry of Children and Education. These institutions were also characterised by high debt, overcapacity, declining enrolment, and by having exhausted their liquidity options. Appendix 2 provides a brief summary of the 10 institutions in financial distress.

The purpose of the study is to assess whether the Ministry of Higher Education and Science and the Ministry of Children and Education have ensured that when financing property, the institutions of education take due financial considerations into account. The report answers the following questions:

- Have the institutions of education taken due financial considerations into account when financing property?
- Have the Ministry of Higher Education and Science and the Ministry of Children and Education's supervision of how the institutions of education finance property been satisfactory?



Conclusion

It is Rigsrevisionen's assessment that the Ministry of Higher Education and Science and the Ministry of Children and Education have not sufficiently ensured that government-funded independent institutions of education take due financial considerations into account in financing property. Favourable lending terms and the government's practice of ensuring the continued existence of institutions that find themselves in difficult financial circumstances have the consequence that the institutions can increase their indebtedness without risking bankruptcy.

Total debt in the sector increased by 55% from 2011 to 2018. At the same time, the Ministry of Higher Education and Science as well as the Ministry of Children and Education are aware that per-capita grants (pupils and students), which are the primary source of income for the institutions, will drop, because the year groups of young people are shrinking in the years ahead. Rigsrevisionen finds that this development entails a risk that the future income of several institutions will not suffice to cover the interest on the accumulated debt - and particularly not, if the debt continues to grow.

The study also found that several institutions of education are not applying the principle of economy in their financing of property, and are taking a risk by entering, for example, swap agreements, postponing expenditure through interest-only loans and mortgaging their property beyond the market value without considering and justifying the risk associated with doing so. In the opinion of Rigsrevisionen, the institutions' debt-financing model should have been assessed in a financial strategy in the context of the estimated future revenue of the individual institutions and the institutions' possibilities of adjusting their capacity. 82 institutions have entered swap agreements etc. that would have led to combined losses of approx. DKK 1.3 billion by the end of 2017, had the institutions been required to repay their debt. In many cases, the same institutions are tied down by excessive interest rates following speculative financing models that end up costing most of them money rather than saving them money. If the motivation for entering swap agreements was interest-rate protection, this could have been achieved at a lower rate and with less risk by taking out a convertible fixed-rate mortgage loan.

The study also showed that the supervision of the indebtedness of the independent institutions of education, conducted by the Ministry of Higher Education and Science and the Ministry of Children and Education, is not satisfactory. The ministries are not considering the combined exposure of the sector in their supervision, nor do they explicitly monitor whether the institutions might be over-extended, or if the institutions are employing high-risk financial instruments. In addition, the supervision conducted by the two ministries is based on financial key figures for indebtedness, including, among others, solvency ratios and funding rates. However, these key figures do not always provide an accurate representation of risk, because they are based on the accounting value of the property, and this does not necessarily reflect the actual market value of the property, was it to be sold to repay a loan.

Rigsrevisionen finds that the Ministry of Higher Education and Science and the Ministry of Children and Education should strengthen their supervision, particularly because 1. The government has so far covered the losses, when government-funded institutions of education with ownership of property and have mismanaged and run into financial difficulties, and 2. The overall framework set for financing and mortgaging is quite wide.

The Ministry of Children and Education notes that Rigsrevisionen points to central and essential problems that call for renewed political considerations concerning the regulation of this area, including consideration of specific actions to address the issues raised. The Ministry of Higher Education and Science states that the report includes a number of useful recommendations concerning the conduct of the institutions and the ministry's supervision. Recommendations that the ministry intends to incorporate in its guidance to the institutions and in the ministry's internal procedures.