Future Arrangements for Capital Funding: Consultation

13 March 2007	**Ref: W07/11HE**
To:	Heads of higher education institutions in Wales
Summary:	This Circular invites comments on proposals for a revised approach to the Council's arrangements for capital funding from 2008-09 onwards, and announces a consultation event.
Response by:	For nominations to attend the consultation event – **2 April 2007** For responses to the Circular – **18 May 2007**
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INTRODUCTION

1 This Circular invites comments on proposals for a revised approach to the Council's arrangements for capital funding from 2008-09 onwards, and announces a consultation event.

BACKGROUND

2 In 2005/06, the UK higher education funding bodies jointly commissioned JM Consulting Ltd to undertake a study on future requirements for capital investment in HE. The outcomes of this work have been published on the HEFCW website. In the light of the study's findings and more general considerations, the Council has subsequently reviewed its arrangements for the provision of capital funding from 2008-09 onwards. The proposed new approach is set out for comment in this Circular.

PRESENT ARRANGEMENTS FOR CAPITAL FUNDING

3 The Council has provided institutions with capital funding for learning and teaching and for research since the reinstatement of the capital funding line in 1999. In 2006-07 and 2007-08, the levels of funding which it provides are as follows:

- *Capital funding for learning and teaching and IT infrastructure* – around £7 million per annum.

- *Capital funding for research* - £10.8 million per annum. This funding is allocated as part of the UK-wide Science Research Investment Fund.

4 In addition to the above funding (referred to in this paper as "mainstream capital funding"), the Council also provides supplementary capital funding allocations in some years. This is drawn from additional end-of-year flexibility funding made available by the Welsh Assembly Government and is usually tied to a specific, targeted objective (e.g. capital investment to comply with disability legislation).

5 In all cases, funding is allocated by formula, and institutions are required to provide the Council with plans for the use of their allocations. There is a requirement to spend each year's allocation within year, and the Council monitors institutions' expenditure annually against the agreed plans.

PROPOSED REVISED APPROACH

6 The capital funding which the Council has provided to date has undoubtedly secured very significant improvements in the quality of the sector's infrastructure for learning and teaching and for research. However, the present approach to funding has a number of limitations:

- the funding is effectively provided to support individual projects, with a detailed focus on how institutions spend each tranche of funding, but relatively little consideration of the wider strategic context, or the extent to which the expenditure is contributing to institutions' longer-term sustainability

- institutions' investment decisions are significantly constrained by the requirement to spend each year's allocation within year

- in the case of learning and teaching capital, institutions tend to use their allocations to support a wide range of relatively small items of expenditure, rather than large-scale investments which are more likely to have significant impact. Moreover, estates investment does not figure as significantly as would be expected. These problems are likely to be connected to the smaller size of learning and teaching capital allocations compared with those for research, coupled with tight expenditure deadlines.

7 In considering the basis on which capital funding should be provided from 2008-09, when the current round of allocations comes to an end, it is proposed that the Council should revise its arrangements in order to:

- place greater emphasis on the promotion of institutions' long-term sustainability

- allow greater flexibility and reduce the accountability burden on institutions.

8 The various features of the proposed changes are discussed in more detail below.

PROMOTING INSTITUTIONAL SUSTAINABILITY

9 The promotion of the long term sustainability of HEIs has become an increasing priority for the funding bodies over the last few years. Actions which have been taken include:

- the development of the Transparent Approach to Costing (TRAC) system, which enables institutions to identify the costs of their activities
- the identification of a set of "trigger metrics" to enable the funding bodies to assess the sustainability of institutions on an annual basis
- a requirement for institutions to incorporate consideration of sustainability into their annual strategic planning process.

10 A properly planned approach to capital investment is essential for institutions' long-term sustainability, and encouraging such an approach would clearly be consistent with wider existing policy considerations. The JM Consulting Study found that a few institutions already have costed and prioritised ten-year capital investment strategies, but such institutions are still in the minority. The advantage of such a strategy is that it provides institutions with a clear picture of their needs and priorities, and enables them to use funding strategically to meet those needs as it becomes available.

11 It is proposed that, in order to encourage institutions to take a more strategic, long-term approach to capital investment, we should move towards a position where institutions are asked to provide capital investment strategies. The aim, ideally, would be to ensure that all institutions establish a prioritised and costed framework for the major items of capital investment required over, say, the next ten years.

12 The capital investment strategy would probably be a stand-alone document, but would be expected to relate closely to institutions' strategic plans and their estates strategies. It would cover the full range of capital investment requirements, including estates, IT infrastructure, equipment for learning and teaching and research infrastructure. It should also indicate the measurable benefits which the investment would deliver.

13 Institutions' capital investment is, of course, funded from a variety of sources, not just HEFCW's capital funding. The capital investment strategies would therefore need to cover the entirety of institutions' capital expenditure, including that funded from sources other than HEFCW allocations. In the case of the latter, the Council cannot make funding commitments which extend beyond the latest funding period. However, this should not prevent institutions from taking a longer-term view of their capital funding needs, priorities for funding, and the mix of potential funding sources.

14 It is envisaged that the precise format of the capital investment strategies will be developed through a process of collective dialogue between Council officers and Directors of Finance or other appropriate members of institutional staff. With that in mind, a consultation event will be held at the HEFCW offices on **Monday, 23 April 2007.** Further details about this event are provided in paragraphs 30 to 32 below.

Comments are invited on the proposal that institutions should develop long-term capital investment strategies.

15 Where institutions are able to demonstrate that they are using their capital funding in a strategic and sustainable manner, it is envisaged that the Council will release its mainstream capital funding allocations with minimal further information requirements. Shifting the focus in this way from detailed, short-term expenditure plans to longer-term strategies would be consistent with the expectation that the Council should engage with the sector at an increasingly strategic level.

16 Institutions which are not able to demonstrate that they are using their capital funding on a sustainable basis would continue to be required to provide detailed expenditure plans for each tranche of funding, as at present.

17 The judgement of whether institutions are using their funding in a sustainable manner would be taken primarily on the basis of the quality of their capital investment strategies. However, in arriving at this judgement, the Council would also make use of a number of metrics-based indicators drawn from existing data (principally HESA and the Estates Management Survey). Examples of the sort of indicators which might be used are shown at **Annex A.** These were developed for this purpose by JM Consulting as part of its work for the UK funding bodies.

Comments are invited on the proposal that, for institutions which demonstrate that they are managing their capital investment in a sustainable manner, mainstream capital allocations should be released with minimal further information requirements. Sustainability would be evidenced by the quality of institutions' capital investment strategies and the outcomes of metrics-based indicators.

FLEXIBILITY

Expenditure Deadlines

18 At present, the Council specifies that expenditure of each annual tranche of capital funding should be completed within year. Although the Council seeks to give institutions as much advance notice of allocations as possible, to allow for forward planning, the present system of tight expenditure deadlines does nevertheless represent a constraint on optimal use of funding. Institutions' decisions on the use of their allocations are necessarily driven in part by expenditure deadlines, rather than by considerations of how to secure best value and their own academic objectives. This is a particular problem in the case of

very large projects (e.g. new buildings) which require a long lead time, or which can encounter unexpected delays.

19 In order to give institutions greater flexibility, it is proposed that they should be able to use their funding over a longer period. This would be consistent with the more strategic and long-term approach to capital investment which the Council would be seeking to encourage through the introduction of capital investment strategies. It would also enable institutions to build up sufficient funds to invest in larger-scale projects, should they so wish. This would help address the fact that, as indicated in paragraph 6, at present many institutions are using their capital funding for learning and teaching to support a range of relatively small items of expenditure which do not have major impact.

20 Accordingly, it is envisaged that, in future, the Council would release its mainstream capital funding on a profile basis, as is already the case in most instances, and monitor the general pattern of institutions' expenditure against their allocations on an annual basis using HESA finance data.

21 The Council will also use HESA data to monitor the level of institutions' **total** capital expenditure from all sources (i.e. HEFCW funding and non-HEFCW funding). This will enable it to make sure that, under the new arrangements, HEFCW capital funding is not being substituted for expenditure which would otherwise have been incurred from institutional sources.

22 Whilst seeking to encourage a more strategic approach to funding, and give institutions greater flexibility, it continues to be important for the Council to be able to identify concrete benefits from capital investment, not least so that it can justify the continued provision of funding to its sponsoring body, the Assembly. It is therefore envisaged that, at the end of each two-year funding period, institutions would be asked to provide a number of case studies on how their allocations have been used. Wherever possible, these case studies should focus on large-scale investments which have had major impact. The Council would then use these case studies to illustrate the benefits of the funding.

Comments are invited on:

- ***the proposal that institutions should be permitted to use their allocations over more than one year***

- ***the proposed new monitoring arrangements, as set out in paragraphs 20 to 22.***

Funding Streams

23 At present, as noted above, the Council operates separate funding streams for learning and teaching and research capital; announcements of allocations are made at different times, and the terms of the funding are also different. Historically, there have been good reasons for this – not least the fact that capital funding for research (SRIF) was provided specifically to address the historic underinvestment in research infrastructure, and therefore required very specifically targeted terms of funding.

24 Looking to the future, however, there would now seem to be a case for bringing the two funding streams more closely together. This would encourage institutions to take a more integrated and holistic approach to the planning of their capital investment. They would, for example, be able to plan refurbishment of buildings used for both teaching and research as a whole, and would also be more likely to

consider investment in the generic infrastructure which underpins both teaching and research.

25 It is envisaged that the Council would nevertheless continue to calculate capital allocations for research and learning and teaching separately in order to demonstrate clearly that support is being provided for both functions, and to enable institutions to understand readily how their allocations are derived. However, the two sets of allocation could be announced in a single Circular, and with common administrative processes.

Comments are invited on the proposal that capital funding allocations for research and for learning and teaching should be announced together and with common administrative processes.

OTHER ISSUES

Levels of Funding

26 The JM Consulting report noted that, although the level of capital funding for research (SRIF) is proportionately broadly comparable to that in England, capital funding for learning and teaching is rather lower. The Council has agreed that capital funding for learning and teaching should be identified as a priority area for additional support in discussions with the Assembly.

End of Year Flexibility Funding

27 As noted above, mainstream capital funding has, in some years, been augmented by additional end-of-year flexibility funding made available to the Council by the Assembly. In order to secure such funding from the Assembly, the Council is required to allocate it in support of a specific, targeted purpose, such as compliance with the requirements of disability legislation. Consequently such funding is necessarily more closely constrained than the main allocations for learning and teaching.

28 The Council would not want to lose the ability to make good use of any such funds if they became available. As part of the general process of consultation on the revised capital funding arrangements, Council officers will work with Directors of Finance and others to identify appropriate areas of capital expenditure which could be proposed to the Assembly for any end-of-year flexibility allocations which may become available over the next few years. This would give institutions some assistance with forward planning.

Office of Science and Innovation

29 The proposals contained in this paper have been discussed with the Office of Science and Innovation (OSI), which has co-funded the Science Research Investment Fund (SRIF). It is understood that the OSI is likely to consult on its own future approach to capital funding later this year, and that HEFCW's approach is likely to be compatible with the OSI's proposals.

CONSULTATION EVENT

30 As indicated in paragraph 14 above, the Council is holding a consultation event to discuss the proposals in this paper and, in particular, to allow for collective

discussion about the content and format of the proposed capital investment plans.

31 This event will be held at **2.00 pm** on **Monday, 23 April 2007**, at the HEFCW offices in Llanishen, Cardiff. Each institution is invited to send up to two members of staff to attend the event who should, between them, be able effectively to represent institutional views on strategic approaches to capital investment and on capital requirements for general infrastructure, for research and for learning and teaching.

32 The names, job titles and email addresses of those attending should be submitted to Linda Tiller by email by **Monday, 2 April** (linda.tiller@hefcw.ac.uk)**.**

TIMETABLE FOR SUBSEQUENT STAGES

Arrangements for capital funding from 2008-09 finalised in light of consultation responses	July 2007
Provisional capital funding allocations for 2008-09 and 2009-10 announced	October 2007
HEIs submit capital investment strategies	February 2008
HEFCW reviews capital investment strategies	March 2008
First payments of 2008-09 allocations released for institutions which qualify for funding on the basis of strategies alone; remaining institutions submit expenditure plans.	May 2008

SUMMARY OF ISSUES FOR COMMENT

33 Comments are invited on the following proposals:

a) that institutions should develop long-term capital investment strategies

b) that, for institutions which are managing their capital investment in a sustainable manner, mainstream capital allocations should be released on the basis of capital investment strategies alone, with minimal further information requirements. Sustainability would be evidenced by the quality of institutions' capital investment strategies and the outcomes of metrics-base indicators.

c) that institutions should be permitted to use their allocations over more than one year

d) that monitoring arrangements should be as set out in paragraphs 20 to 22

e) that capital funding allocations for research and for learning and teaching should be announced together and with common administrative processes.

RESPONSES AND FURTHER INFORMATION

34 Please would you submit responses by email to Linda Tiller (linda.tiller@hefcw.ac.uk) as follows:

- the names, job titles and email addresses of up to two members of staff to attend the consultation event by **Monday, 2 April 2007**

- responses to the consultation by **Friday, 18 May 2007**

35 Any queries arising from this Circular should also be addressed to Linda Tiller (tel 029 2068 2228; email linda.tiller@hefcw.ac.uk).

ANNEX A

Possible diagnostic tool to categorise institutions re capital funding schemes

(The purpose of this table is to use readily-available metrics to help funding bodies to decide which institutions have the long-term capacity to service their existing infrastructure.

	Criterion	Group A. sustainable (with some funding) (satisfy all following criteria)	Group B. need explanation and strategy development, and in some cases possibly some rationalisation (one or more of the following)
1.	**CE/CP ratio*** (HESA and EMS)	Below or close to 2.0 (up to 2.5 allowable if research-intensive)	Above 2.5 (indicating possible threat, needing consideration)
2.	**Actual spend on infrastructure** Average amount spent as % of asset value over 3 years (HESA and EMS)	Close to indicative level of 4.5% (or if below have a good reason – new campus etc)	Well below 4.5% (without justification) (indicating unsustainable without some improvement)
3.	**Good practice**	a. Institution has a 10-year capital plan, which is financed, and addresses all problems and backlogs that will threaten sustainability b. As part of this, institution has agreed a required annual investment level of [X%] of asset value and this will enable it to manage infrastructure investment (with appropriate assumptions about public capital grants)	No evidence: cannot make these declarations

** Note: The CE/CP ratio is the ratio of "cost of equity" to "cost of production", where the cost of equity is the insured valued of the non-residential estate and the cost of production is the institution's total income (excluding residential and catering income).*