February 2006

Impact of changes to HEFCE capital funding arrangements between 2004-06 and 2006-08

A report to HEFCE by PA Consulting

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EXECUTIVE SUMMARY

As part of its commitment to reducing the administrative and accountability burdens on higher education institutions (HEIs), HEFCE has introduced wide-ranging changes to the ways in which capital funding for teaching and learning and for research is distributed to the sector. Although some of these changes are quite technical and procedural in nature, their combined effect is to transform this aspect of HE funding, from a disjointed set of bidding competitions to an integrated process for long-term infrastructure planning. This study has sought to identify and evaluate the impact of recent changes on HEIs, and estimate the value of the benefits that can be attributed to them.

The changes in scope were introduced by HEFCE between the 2004-06 and 2006-08 capital funding rounds, and can be grouped under five distinct headings:

i. Coordination of schemes – the multiple capital schemes operated in the past have been combined into two programmes, teaching and learning capital (TLC) and the Science Research Investment Fund (SRIF), with both schemes administered through a single combined process and timetable (see Appendix A). The net effect of this is to bring forward the timing of milestones, for example the acceptance date for TLC capital proposals is six months earlier than the previous round.

ii. Timing – short-term, project-specific funding allocations have been replaced by two-year programme allocations, which institutions can reasonably assume will continue at more or less the same levels in future years, while recognising the uncertainty beyond the end of the current government spending review.

iii. Processes – different paper-based application procedures for each funding scheme have been replaced by a single, on-line process for demonstrating that allocated funds will be applied for the intended purposes, with built-in verification checks to eliminate the need for ad hoc information requests and a greatly streamlined assessment and approval process.

iv. Information – instead of detailed project information, the main requirement is for institutions to demonstrate that their planned uses of the allocated funds fit with their academic and other strategies and can be afforded within available resources.

v. Audit – the project-related audit requirements, for bids and projects, have been greatly reduced, with only selective and high level audits required for major programmes, and with HEFCE paying the costs of such reviews.

We have reported the impact in terms of the direct impacts on staff and non-staff costs and related benefits, and the indirect impacts on project and capital programme costs and benefits.

Direct benefits relate to the impacts of the changed arrangements for staff time and non-staff costs. We estimate that the savings realised by the sector amount to approximately £2.2 million as a result of the changed funding arrangements. While not a large saving in absolute terms, this impact represents approximately a 50% saving on the relevant costs under the previous arrangements.

Indirect benefits identified include the acceleration of project benefits and an impact on the cost of capital. We have concluded that the changed arrangements provide the sector with an opportunity to translate greater certainty into actionable capital plans earlier than would have been possible under the previous arrangements. The impact on institutions of being able to deliver these plans earlier will be to realise the benefits sooner. The impact depends on the actual financial return of the capital investment being brought forward, but this could amount to hundreds of millions of pounds to the sector. While there is good evidence to support the fact that many HEIs are planning to accelerate investment, few have been able to realise any immediate benefit. There are also those HEIs that are not expecting to realise any benefit from these changes.

The impact of increased planning certainty for the cost of capital presents the sector with an opportunity to reduce finance costs worth in the region of £5-£7 million a year. However, our study has found that the relationship between planning certainty and HEI cost of capital is not well understood across the sector.

While the potential value of these indirect benefits is significant, they cannot be substantiated at this time because (a) the benefits will only accrue at later stages of an investment cycle that is just starting, and (b) the extent to which institutions actually realise the potential benefits is largely determined by their own management systems and investment strategies.

Overall the collective impact of the changes to the capital funding to the sector are important and a clear further step in the right direction. Real benefits have already been realised by institutions, and there is scope for significant further benefits as a direct consequence of the changes. This was confirmed from discussions with HEIs, which all recognised the benefits for them from the reduction in the costs of accountability, improved communication of funding schemes and measures that increase the certainty of future funding.

Looking ahead, HEIs flagged further changes that would extend these benefits. There is a widespread desire for a 'single cheque' for funding to give institutions the control to manage the most efficient allocation of resources. This seems to echo the sector's current call for a 'single conversation' about monitoring and accountability. Many of the other suggestions captured from institutions related to further increases in the flexibility of funding rules, including the carry forward/back of allocations between funding rounds.

It is clear that the relationship between HEFCE making changes to the capital funding process and the realisation of benefits is a complex one. To a large extent, institutions' ability to realise benefits from changes in accountability requirements is influenced by their internal management systems and practices. During our fieldwork we repeatedly observed that the ability of an organisation to take advantage of the changes in capital arrangements was influenced by three themes: the adoption of strategic and risk-based management approaches, the financial flexibility the institution possesses, and the scale of the institution's capital programme.

We believe that it would be feasible to build a framework for managing capital funding arrangements around these characteristics and to develop a risk-based approach to managing accountability for capital funding. This approach would encourage HEIs to adopt best practice approaches to managing capital programmes that will ultimately lead to better and more coherent decisions being made. It would also provide HEFCE with a mechanism to focus time and effort on those institutions that require attention, and allow those institutions that are sufficiently robust and well managed to focus on managing their plans rather than managing the funding process.

We found that many institutions have already embraced good practice and started down the path of implementing sound approaches to strategic capital programme management, relating sound corporate governance to effective control and information systems.

However, it is also clear that all institutions have to continue to work hard to demonstrate that they can be benchmarked against best practice across other sectors and countries, particularly if they are ultimately going to be successful in lobbying HEFCE and Government for increased self-regulation of their publicly funded activities.

2. INTRODUCTION

As part of its commitment to reducing the administrative and accountability burdens on higher education institutions (HEIs), HEFCE has introduced wide-ranging changes to the ways in which capital funding for teaching and learning and for research is distributed to the sector. Although some of these changes are quite technical and procedural in nature, their combined effect is to transform this aspect of HE funding, from a disjointed set of bidding competitions to an integrated process for long-term infrastructure planning. This study has sought to identify and evaluate the impact of recent changes on HEIs, and estimate the value of the benefits that can be attributed to them. The scope of this study is limited to those changes made between the 2004-06 and the 2006-08 funding rounds.

This was a challenging remit, for both technical and practical reasons. Technically, the challenge was to identify and attribute monetary savings from procedural impacts, many of which are essentially qualitative – better quality planning, better project selection, better project results. Practically, as we have found in our earlier work on accountability costs, the wide differences between institutions, and the lack of internal cost management information, makes it difficult to extrapolate findings from particular HEIs to the whole sector. Nonetheless, and with appropriate caveats, the challenges were overcome. The key to meeting both sets of challenges was to adopt a structured and systematic approach that was relevant across a diverse range of institutions.

The methodology we followed for this study is similar to the approach applied successfully in our previous studies of accountability costs[1]. This methodology produced costing results which were recognised and endorsed by the sector and were also accepted by HEFCE, DfES and HM Treasury as sound and robust.

The key elements of our methodology were as follows:

i. Identifying the business processes, and particular sub-processes, affected by the changed funding arrangements.

ii. Identifying the full range of staff and non-staff costs driven by HEFCE requirements for each process, and what the relevant cost drivers are in each case.

iii. Working with institution experts to identify and quantify the changes in those cost drivers attributable to the changed funding arrangements.

iv. Using institutions' own cost data to attach monetary values to those changes, distinguishing direct and indirect costs and above-the-line and below-the-line measurement.

v. Extrapolating the findings from the initial sample across all institutions, using the relevant cost drivers.

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[1] PA Consulting, 'Better accountability revisited: review of accountability costs 2004', June 2004, www.hefce.ac.uk under Publications/R&D reports

In this report we present:

- Analysis of the impacts and benefits of the changes in capital funding on the business operations of HEIs
- Estimation of the value of those benefits for the institutions sampled
- Extrapolations of those estimates to produce calculations, with caveats, for the overall benefits that the changes have enabled across the sector
- Observations about the particular circumstances and characteristics influencing the experiences of different institutions with regard to the changes in capital funding arrangements
- Suggestions for further changes, identified from the study, and implications for the capital funding framework.

During this study we were able to work with a total of 23 HEIs, involving more than 75 interviewees. The sample includes a representation from each group of institutions (including Russell Group, pre-1992 and post-1992 universities, and the smaller teaching-based HEIs). The total number of HEIs involved in this study represents more than15% of the HEIs receiving capital funding for teaching and for teaching and learning. We could not have done this without the active help of all universities and colleges, which was freely given. We would like to express our thanks to the senior management and staff of all the institutions visited for making us welcome.

3. CHANGES TO CAPITAL FUNDING PROCESS

The changes introduced by HEFCE between the 2004-06 and 2006-08 capital funding rounds can be grouped under five distinct headings:

i. Coordination of schemes – the multiple capital schemes operated in the past have been combined into two programmes, teaching and learning capital (TLC) and the Science Research Investment Fund (SRIF), with both schemes administered through a single combined process and timetable (see Appendix A). The net effect of this is to bring forward the timing of milestones, for example the acceptance date for TLC proposals is six months earlier than the previous round (ignoring the effect of the delayed announcement of Project Capital 3).

ii. Timing – short-term, project-specific funding allocations have been replaced by two-year programme allocations, which institutions can reasonably assume will continue at more or less the same levels in future years, while recognising the uncertainty beyond the end of the current government spending review.

iii. Processes – different paper-based application procedures for each funding scheme have been replaced by a single, on-line process for demonstrating that allocated funds will be applied for the intended purposes, with built-in verification checks to eliminate the need for ad hoc information requests and a greatly streamlined assessment and approval process.

iv. Information – instead of detailed project information, the main requirement is for institutions to demonstrate that their planned uses of the allocated funds fit with their infrastructure strategies and can be afforded within available resources.

v. Audit – the project-related audit requirements, for bids and projects, have been greatly reduced, with only selective and high level audits required for major programmes, and with HEFCE paying the costs of such reviews.

The impacts of these changes on institutions, many of which have yet to be fully experienced as the changes apply to the 2006-08 funding round, result from the combined effects of all six sets of reforms; there is no simple mapping from, say, changes in the approvals process, to institutional administrative costs.

HEFCE intended these changes to deliver the following benefits to HEIs:

- direct costs – reduction in the direct costs associated with administering HEFCE capital funding (from initial proposal development, through submission, to drawing down funds and final completion audits)
- cost of capital – reduction of the project cost of capital resulting from greater planning certainty (including the earlier draw-down for HEFCE monies) together with a reduction of HEI cost of capital resulting from greater certainty of the capital funding stream. HEFCE’s hypothesis is that this should contribute to a lower risk profile for individual projects and ultimately for the institution’s total capital programme
- accelerated flow of benefits– the combination of an earlier planning timetable, the earlier start date and greater certainty of further funding rounds should enable HEIs to start projects earlier and therefore realise the project benefits sooner.

In summary, we have classified the potential benefits in the following terms, with an assessment of their anticipated impact on HEIs.

Figure 1: Potential Impact of Changed Funding Arrangements

Impact of Changes	Direct Costs	Project Cost of Capital	Institutional Cost of Capital	Accelerated Benefits Flow
Earlier Timing & Greater Certainty	Medium	Medium	Medium	High
Simplification and Automation of Process	High	Low	Low	Low
Simplification of Content	High	Low	Low	Low
Reduction in Audit and Review	High	Low	Low	Low

In order to assess the realisation of the potential benefits, we considered the impact of the changed funding arrangements on the relevant high level business processes for institutions. This gave us a structured basis for identifying and comparing the activities and non-staff cost drivers for each main process, and hence for estimating the financial impacts.

4. ASSESSING THE IMPACT OF THE CHANGES

4.1 METHODOLOGY FOR ASSESSING COST IMPACTS

At a high level, the institutional business processes affected by the changed funding arrangements, and the kinds of benefits that might be expected from them, are shown in Figure 2 below:

Figure 2: Structure for summarising impacts of changes

Impacts on Higher Education Institutions	
Direct Impacts	**Indirect Impacts**
Staff Costs (E.g. Attributed administration time and academic time)	**Staff Costs** (E.g. Opportunity cost of freeing up staff to work on value adding activities)
Non-Staff Costs (E.g. Reduction in cost of audits)	**Non-Staff Costs** (E.g. Better planning and project decisions, savings from stronger tendering position, accelerated project benefits, cost of capital reduction etc)

We have drawn a distinction between the 'direct impacts' of generating and responding to specific funding requirements, such as proposal submissions, audit visits, etc, and the 'indirect impacts' factored into ongoing institutional operations. For the purposes of this study, we have concentrated on identifying areas and activities where HEFCE funding arrangements have imposed costs that the institutions believe are greater than those that would otherwise be incurred.

4.2 ASSESSMENT OF DIRECT COST BENEFITS

4.2.1 Staff Costs

From discussions with HEIs we have produced an estimation of the direct staff time and effort costs required to support both the TLC and SRIF capital funding process. Our sample of HEIs reported an average reduction in direct staff time between 2004-06 and 2006-08 of 46%, representing an average estimated cost saving to each HEI of £10,900 per funding round (see Figure 3).

Figure 3: Assessment of reductions in direct staff time

	2004-06	2006-08	Impact of Change
Detailed HEI sample size	13	13	
Representing:			
Number of projects	121	117	
Total capital funding (TLC & SRIF)	£192,913,067	£202,004,409	
Average Time Invested by each HEI in the HEFCE capital funding process:			
Number of staff weeks	21.9	11.9	-10.0
FTE required	0.46	0.25	-0.2
Average overall % Reduction			**-46%**
Average Cost per HEI (£)	**£23,800**	**£12,900**	**-£10,900**

In addition to the savings in direct staff time, there is an important unmeasured opportunity cost because much of the time and effort required is that of senior management (including operating board, academic and directorate heads) and professional staff (including project managers and accountants). Generally the impact has been for this freed time to be reinvested in better quality planning and strategic processes. The return in terms of better long-range planning, strategic management and ultimately better capital decisions is at this stage unmeasured.

The main drivers for the reduction in direct staff time resulted from the lighter touch that HEFCE required for the submission, and particularly the focus on programme-level rather than project-level information. It is therefore reasonable to expect all institutions to have had the same opportunity to reduce the required time and effort.

Notable Exceptions

From our sample of HEIs there were one or two institutions where there were no reported savings in staff time. In these cases management explained that the extra time was reinvested into the process to provide better cases, with the aim of delivering lower risk and better project outcomes. With this in mind we would conclude that the HEFCE ‘light-touch’ approach actually encourages HEIs to place greater reliance on their internal controls and management approaches, and that it makes institutions more aware of any deficiencies in those systems.

One HEI reported an increase in staff time committed to the 2006-08 funding round from the previous round. However, this increase was attributed to changes made to internal processes, in this case moving from a top-down approach to a more democratic bottom-up process to agreeing proposals. Several HEIs adopted elements of bottom-up proposal development. Generally this would involve academic and service heads putting forward proposed projects, often resulting in significant over-subscription of the capital allocation. This would then require a significant amount of senior management time to sift and prioritise projects. The approach was most common in respect of SRIF proposals, and least common for estates focussed projects, which were usually subject to regular review against a reasonably robust estates strategy and generally had a single senior sponsor.

4.2.2 Non-Staff Costs

Consultant Costs

One or two HEIs employed consultants to assist them with the development of their HEFCE submissions. This involvement included generating specifications and detailed costings. The time and cost impact of this activity was included in the estimation of the direct time and costs and has already been commented on in the section above.

Audit Costs

The project-related audit requirements, for bids and projects, have been greatly reduced, with only selective and high level audits required for major programmes, and with HEFCE paying the costs of such reviews.

Currently, HEIs complete audits using either internal audit if they have this function (with the operation being recharged the cost of these services), or external accountants and auditors. Although projects vary greatly in size and complexity, the average audit requires half a day to complete at an average cost of £500 per audit. Based on the HEIs sampled, the average number of projects per HEI was nine, representing a saving of £4,500 per HEI.

4.3 ASSESSMENT OF INDIRECT BENEFITS

4.3.1 Acceleration of Benefits

Beyond the impact on HEIs' direct costs, we investigated with institutions the wider benefits of these changes on their capital planning, the most important of which are:

- consolidation of capital funding allocations to two core streams, based on transparent formulae
- earlier draw-down of funding, brought forward by up to by 12 months
- assumptions that current funding levels will continue in the future.

Supported by our fieldwork (and the survey detailed in section 4.4) these changes have collectively provided institutions with a higher degree of planning certainty. This can be exploited in several ways:

- more strategic approaches to estate planning, with up to three years' visibility of funding
- programme approach to estate management to allow sensible management of interdependencies
- reduction of funding risk.

The opportunity to the sector is to translate this greater certainty into actionable capital plans earlier than would have been possible under the previous arrangements. As a result institutions will be to realise the benefits sooner.

The challenge was to assess the financial impact of accelerating these benefits across the sector. Our approach was to examine the last round of funding (TLC and SRIF for 2006-08) to gain an understanding of institutions' capital investment profiles. The key findings from our review of investment data are:

- average project length is 22 months, with net useable building space of 5,136 m^2
- average building investment is £2.7 million per project, net of VAT. Related equipment represents approximately 11% of total spend
- against the 2006-07 profile, the break-even, annual return over 10 years as a percentage of gross investment is 12.2%. This return comprises student fees, research income and cost savings; less related operating costs, on a full lifecycle basis.

On the premise that institutions make rational planning decisions, we find it a reasonable assumption that institutional investment generates real and positive financial returns. In Figure 4 we have detailed the net present values of the 2006-08 investments, each calculated at the annual return rates shown over 10 years from project close.

Figure 4 Net present values of 2006-08 investments

Annual payback on gross cost	Extrapolated gross return (NPV @ 3.5%) on total HEFCE funded capital 2006-08	Average NPV return per £1million of investments, at each level of payback
12.2%	£0	£0
13%	£152,854,000	£58,083
14%	£353,024,000	£134,135
15%	£553,194,000	£210,207

Figure 4 assesses the impact on institutions of being able to deliver these plans earlier in terms of NPV per million of investment, depending on a specific project or programmes payback. From this we conclude that the benefits of bringing forward investment are potentially very significant. However, the realisation of these benefits will vary greatly across institutions, depending on three variables: the proportion of their capital investment plans that is brought forward; the extent to which HEFCE capital grants are leveraged from other sources of funds; and the economic return (above break-even) that the institution is achieving from its capital funding. While it has not been possible to assert with any certainty the extent to which institutions have in practice brought forward planned investments, we have been able to gain some insights on the possible scale of this benefit, discussed under section 5.2 in the chapter on 'Capital funding impacts and issues'.

4.3.2 Cost of Capital

From discussions with HEIs, improved certainty of funding can generate savings in the cost of capital of between 15 and 20 basis points (between 0.15% and 0.20%). Financial forecasts supplied by HEFCE indicate that HEI external borrowings for 2005-06 to 2007-

08 will be approximately £3.4 billion to £3.5 billion[2]. Accordingly, the projected financial effects are a net reduction in finance costs of approximately £5 million to £7 million per annum. This projection is however difficult to validate since the effects are only likely to be realised and therefore tested over a longer period of time.

4.4 FIELDWORK FINDINGS AND SURVEY RESULTS

To test that our findings were representative of the sector and permit extrapolation over the sector we extended our sample to incorporate telephone interviews with a further group of HEIs. Figure 5 details the attitudes of institutions to the changed capital funding arrangements.

[2] HEFCE 2005/06 'Financial forecasts, annual monitoring and corporate planning statements', January 2005

Figure 5 HEIs' views of the changed funding arrangements

Responses to questions relating to the changes made		Significantly Reduced	Marginally Reduced	Marginally Increased	Significantly Increased
1	Changes made to the 2006-08 capital funding arrangements compared to 2004-06 have had what impact on time and effort of HEI staff and non-staff costs	0%	100%	0%	0%
		Strongly Agee	Agree	Disagree	Strongly Disagree
2	You have benefited from the earlier timetable and project start times	13%	50%	38%	0%
3	You have benefited from the ability to draw down funding earlier than the previous round	13%	50%	38%	0%
4	The changes made to the capital funding arrangements have added certainty to your capital funding investment plans	0%	50%	50%	0%
5	The changes made to the capital funding arrangements have reduced the project and or HEI cost of capital	0%	13%	88%	0%

Direct Costs – Staff and Non-Staff

A reduction in direct costs associated with the HEFCE capital funding process was widely reported. It is interesting to note that this was qualified in terms of a marginal reduction, which appears at odds with earlier fieldwork results showing a 46% reduction in time and effort. However we need to remember that we estimated that this translated into an estimated saving of just £10,900 per HEI, having low overall materiality to the institution. This result is considered to add further weight to the fieldwork analysis.

Acceleration of Benefits

Questions 2 and 3 relate to the realisation of timing benefits. Taking these two questions together it appears that views on the impacts are mixed. For HEIs that confirmed the changes were a potential benefit, the benefits were mostly yet to be realised. In practical terms the brought-forward projects were initiated but not yet at a stage where any tangible benefit could be quantified. Again this seems to confirm our analysis in section 3.2 that the benefits are still latent at this stage. Taking the two questions together, it is perhaps worrying to note that for each HEI that stated the changes were beneficial, an equal number stated that the changes were of no practical benefit. When probed on the rationale for this response, several stated that while there was a theoretical benefit, their investment plans were already in place and could not be changed at short notice. Interestingly, even those HEIs expecting to realise real benefits often felt that they had missed an opportunity by not claiming draw-down of funding earlier this year.

The majority of HEIs considered the changes to have delivered increased certainty to capital planning. The differences in opinion related to the institutions' attitude to risk. The 67% of HEIs that agreed that planning certainty had increased stated that they were taking HEFCE guidance at face value and planning in anticipation of further funding from the 2008-10 round (although in practice this mainly involved feasibility planning and design costs, and was not yet entailing irreversible major decisions). The remainder of HEIs that did not feel that planning certainty had increased stated that they required a greater level of security that further rounds of funding will actually materialise. This is particularly understandable given the unknown impact of variable fees on student numbers (the main driver of TLC-related revenue) and full economic costing (seen by some as providing a rationale to remove the need for SRIF).

Cost of Capital

From discussions, HEIs indicated that while increased planning certainty would have a longer-term impact on their cost of capital they were not able to quantify any immediate reduction at this point.

In conclusion, the results of our survey generally lend weight to both HEFCE's assessment of potential benefits and our other findings from the fieldwork, although reduced cost of capital is a potential benefit that is difficult to validate at this stage. Overall the survey has provided comfort that the detailed findings from our core sample as detailed in this report can reasonably be extended to the HE sector as a whole, subject to stated caveats.

4.5 EXTRAPOLATION ACROSS THE HEI SECTOR

4.5.1 Direct Costs

Figure 6: Sector-wide direct cost savings

	Cost Saving per HEI per Funding Round	Cost Driver	Extrapolation
Reduction in Direct Staff Time and Effort	**£10,900**	No. of HEIs	**£1,427,900**
Reduction in Direct Non-Staff Costs	**£4,500**	No. of HEIs	**£589,500**
Total Estimated Reducion in Direct Costs			**£2,017,400**

4.5.2 Indirect

Acceleration of Benefits – Opportunity to Sector

Figure 7: Sector-wide indirect benefits

				Additional NPV to the sector for a range of values expressed as a % of total HEFCE capital funding:			
Annual payback on gross cost	**Gross return NPV @3.5%**	**Return per £1million**	**Driver**	**10%**	**50%**	**100%**	**200%**
12.2%	£0	**£0**	Value of capital funding	**£0**	**£0**	**£0**	**£0**
13%	£152,854	**£58,083**	Value of capital funding	**£8,439,290**	**£42,196,451**	**£84,392,903**	**£168,785,806**
14%	£353,024	**£134,135**	Value of capital funding	**£19,489,424**	**£97,447,119**	**£194,894,238**	**£389,788,477**
15%	£553,194	**£210,207**	Value of capital funding	**£30,542,463**	**£152,712,316**	**£305,424,633**	**£610,849,266**

Figure 7 illustrates the potential value to the sector based on the sector accelerating the value of investments expressed as a percentage of total HEFCE capital funding). We have illustrated the size of the potential benefits over a range of possible values of real rates of return and for total incremental investment. We found in our field work that HEFCE capital grants as a percentage of institutions' total capital funding ranged from 90% (the lowest level of leverage) to 25% (that is, each £1 of HEFCE funds is matched by £3 from other sources), with 40-50% being the average – that is, a leverage effect equivalent to 200% of HEFCE grants.

As we have discussed, it is not possible to estimate the extent to which institutions have in fact brought forward their investments, because it is too early to know the rate of return the project will deliver or how many projects will be accelerated as a result of the changes. Nonetheless, it is clear that there are potential benefits to the sector. For example, even at the low end of the scale the value to the sector of being able to accelerate investments equal to only 10% of HEFCE capital funding could deliver benefits with NPVs between £8.4 million and £30.5 million a year, depending on the actual rate of return achieved.

Cost of Capital

Figure 8: Sector-wide cost of capital

Reduction in Cost of Capital	Forecast HEI Sector Level debt	Extrapolation
15-20pts	£3.4-3.5bn	**£5-7m p.a.**

This represents an opportunity to the sector only, since it is too early in the funding cycle to estimate with any certainty the sector's realisation of this benefit.

4.6 CONSTRAINTS AND CAVEATS

In addition to constraints detailed earlier in this section, our efforts to quantify the cost impacts of funding requirements had to address several complicating considerations:

i. Although we applied a structured and systematic approach to staff and non-staff costs, the lack of 'off the shelf' data on these costs from existing information systems does require us to be cautious about these findings since much of the data came from senior management estimates.

ii. Therefore there is a natural difficulty in isolating the benefits derived specifically from HEFCE changes. For example, several HEIs had changed the process to identify which capital projects should be approved from being a centrally managed, relatively resource-light process, to one that was planned from the bottom up, which is relatively more resource intensive.

iii. Many of the impacts on institutions are yet to be fully experienced as the changes apply to the 2006-08 funding round. For example, many HEIs did not initiate or approve projects internally until the letters confirming funding from HEFCE were received in August 2005. This therefore limits the assessment of the impact of changes since there is little or no data available on what HEIs have been able to act on and/or HEFCE has been able to provide in the way of early funding. It may also be difficult to assess the realisation of these benefits at a point in the future since it is was rare for the HEIs in our sample to conduct post-implementation reviews on the expected benefits from capital projects.

5. CAPITAL FUNDING IMPACTS AND ISSUES

In this section we summarise the qualitative experiences and observations of HE staff within each of the following themes: direct costs, acceleration of project benefits, and cost of capital.

5.1 DIRECT COSTS

Key Issues

Demands on staff time can be influenced by HEFCE, however the most significant driver of direct staff time and effort was found to be the approach adopted internally by HEI management in preparing and managing the capital plan. Institutions that adopted a strategic approach invested the lowest additional amounts of time and effort into external accountability processes. In practical terms the different approaches within HEIs were distinguished by the manner in which they prepared their submissions. Strategy-led organisations put a strong emphasis on top-down planning of projects, whereas those that operated in a more reactive way conducted a largely democratic process. This meant that the level of detail provided by HEIs in their submissions varied greatly.

Impact

Significant reductions in staff time can be realised by management adopting a strategic and proactive approach to capital planning. This does not simply mean the adoption of larger programmes made up of the usual host of smaller tactical projects, it means the adoption of top-down and fully joined-up planning from the corporate strategy to the estates strategy and the financial plan. This will enable the institution to some extent to relegate the HEFCE funding process to an administrative procedure, rather than something triggering a bottom-up planning and decision-making process.

The general comment from HEIs is that the lighter touch has been enormously beneficial, particularly since many institutions are experiencing a period of rapid change. There is some scope for further clarification of HEFCE expectations and of its use of such information.

5.2 ACCELERATION OF PROJECT BENEFITS

5.2.1 Planning certainty

Key Issues

HEIs' responses varied markedly to HEFCE advice that HEIs should assume for planning purposes that future allocations would continue at current levels – from inclusion of 2008-10 allocations in the financial forecast to not believing anything until confirmation letters are received. The amount of benefit that HEIs are able to realise from such planning assumptions depends not just on their appetite for risk but also on the scale of their operations, and the options available should contingencies be required in the event of major political or economic change and the curtailing of capital funding.

Over the last three years all key performance indicators in terms of time, cost, scope and defect performance for project delivery have been met. This is largely due to three factors: smarter procurement, flexible completion dates and longer planning horizons.

- *Smarter procurement: this means mitigating all construction risk upfront. This is achieved by contracting with a supplier (from the panel) to take all delivery risk. There is zero tolerance in terms of no site work starts until contracts are in place. Finally, design teams are novated (in a professional manner) to the construction contractor.*
- *Flexible completion dates: very rarely is a completion date planned in a way that makes it critical to meet. Therefore if there is delay, there is no need to incur claims from contractors due to changes in scope or accelerated working.*
- *Longer planning horizons: resulting from HEFCE changes.*

These changes were made following a number of very large failures in 1995, 1996 and 2000. During this period the value of claims was crudely estimated at £1 million per year or 5% of the annual capital programme, which during this period was about £20 million per year. Therefore the current value of these changes on a capital programme of £40 million a year is very roughly £2 million a year.

There has been benefit from being able to put in estimated SRIF 3 and 4 numbers. In essence it has helped to allow the university to continue to take a more strategic approach to management and particularly capital planning. A portion of the £2 million a year can be claimed from the changes.

Director of Estates

The issue of consistent communication from HEFCE was raised, with several interviewees believing that messages have been too informal and to some extent inconsistent.

Changes have allowed us to increase our planning window with some certainty until 2010. We now build in an estimate for SRIF4. The capital plan includes a list of projects and projected source of funds whether from HEFCE or alternative sources.

Finance Director

Greater certainty is what everyone wants. It is too soon to make changes to plans and behaviour, but certainly we can start thinking about what projects/programme phases may be earmarked for 2008-10 HEFCE funding. However, there is a fear that the introduction of full economic costing will mean that no additional SRIF funding will be available for phase two developments and therefore will require an alternative mix of funding.

Director of Finance

One benefit of greater certainty in capital funding for HEIs that was not initially expected was the impact on procurement processes and outcomes, particularly when negotiating framework agreements. It seems that several HEIs have experienced benefits from the private sector construction industry and associated consultancies understanding that longer-term certainty exists. So rather than contractors seeing the framework agreement being associated with perhaps a single one-off project, followed by unclear further opportunities, they can now see up to five years of capital programme. This puts HEIs in a stronger position to negotiate better commercial terms. It does appear however that these benefits were predominantly noted within mid-sized institutions that rely heavily on the HEFCE funding stream but have projects of sufficient size to leverage greater purchasing power. HEIs with large rolling programmes have sufficient scale to be benefiting from this type of buying power already. At the other end of the spectrum, HEIs with very small capital programmes and low levels of alternative funding put each job out to tender without framework agreements since the costs outweigh the benefits.

It is easier to secure/negotiate deals with central London contractors – especially for the small colleges whose capital programmes are so dependent on HEFCE funds – if we can say that we have funding for the next 4 years. This also delivers qualitative benefits such as securing a single team across multiple phases – increased continuity improves quality and reduces risk. Therefore you get best value (not the same as lowest cost).

Estates Project Manager

While these benefits are qualitative in nature it is worth noting that the benefits of certainty extend to the practicalities of negotiating better commercial terms. Anecdotal evidence from our fieldwork suggests that it is not unreasonable to expect indirect but unmeasured benefits to those HEIs of savings of around 5-10% of supplier costs.

Impact

HEFCE should continue to encourage HEIs to adopt strategic approaches to planning. This should also extend to ensuring that submissions and plans for capital programmes are properly 'joined up' with other corporate strategies and plans. Certainly there was evidence that financial and estates strategies would benefit from increased levels of coherence (for example, in periods of planning and alignment on future commitment planning). It is important however to understand that one size does not fit all, and that individual HEI groups may be better or worse placed to take advantage of changes to the capital funding arrangements.

It is also true to say that there is scope for clarification on the details of the changed arrangements. This should include answering clearly questions such as 'what is an early start', 'when can draw-down be effected, 'how far back can we claim feasibility costs – is there a limit', 'what do we need to do when we change projects', 'what happens to our funding for a project if we manage to secure greater procurement savings than initially estimated'. Since these were all questions that were regularly asked of us it may be worthwhile HEFCE looking at developing a set of answers to frequently asked questions.

For HEIs that have taken on board HEFCE advice to assume that current funding levels will continue, this does have the effect of increasing future financial commitments since plans are beginning to be based on subsequent allocations at the same level. So, if future SRIF and TLC allocations do not meet these expectations there could be significant gaps in committed funding. Whilst there is little evidence to suggest significant future commitments are being locked in, there is at a minimum good evidence that increased levels of feasibility work and spend on consultants are being committed, which is of course a cost to the bottom line for HEIs. Taken in conjunction with key findings from

HEFCE's review of financial statements[3] indicating that debt levels are forecast to increase significantly and cost surpluses expected to stand still at best, the potential effect of a capital funding gap on the sector is high and continues to represent a major risk to HEIs' sustainability.

5.2.2 Realisation of benefits

Key Issues

There is a difference between the opportunity presented to the sector by the HEFCE changes and institutions' experiences in taking advantage of them. This is certainly the case for the acceleration of project benefits.

During our visits there was little systematic evidence of benefits being realised immediately. To some extent this is a factor of being right at the start of the funding cycle for 2006-08. It is also worth noting that lead times for large estates projects can be up to 18 months before the main contract is even signed. This is to take into account design, surveys, planning movements of people during limited periods of the year, and planning permission approvals.

This is not to say that some institutions do not have good plans in place to accelerate projects to achieve benefits early. There were several cases of significant benefits being expected from projects accelerated by up to a year.

> *SRIF 3 – Vet School (£13 million total of which £8 million from SRIF.: The facility is required to launch a new degree in September 2006. Required 12 months design (£750,000), first construction contract just signed for £9.5 million and will be a further £3-4 million following this. Given the lead times it was agreed with HEFCE to have an early start from August. We expect draw-down to be permitted from August.*
>
> *Director of Estates*

> *Our Postgraduate Centre project can be brought forward a whole year, without the changes this would not have been possible. This means we get the operational benefits and the interest benefits.*
>
> *PVC Resources*

> *I strongly agree that the changes provide a benefit to project delivery. Our IT and Media Centre project can be delivered a year early. We expect to put an early claim in for about £1 million in December. This had significant benefits to morale of students and staff, as well as being an important part of our marketing efforts for this intake.*
>
> *Finance Director*

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[3] HEFCE 2005/20, 'Annual monitoring and corporate planning statements, and financial forecasts', April 2005

It is also worth noting that estates-led projects are generally planned in a different way to research equipment projects. Whilst best practice management processes can be observed for estates-led projects, the same cannot be said of research equipment projects, where democratic processes in the main prevail. HEIs generally seem to be grappling with what the best approach is to managing research equipment projects and funding. In many cases HEIs will employ a fail-safe where academic staff are not permitted to spend SRIF allocations until the final HEFCE confirmation letter is received. In other HEIs a further level of post-HEFCE approval is still required before a financial commitment is made. Overall, this suggests that there is a lower level of confidence in the internal processes producing the right outcome, particularly in the case of academic-led projects. It is important to note also that there are few post-implementation reviews into the realisation of the benefits detailed in the original business case.

In most cases the propensity of an HEI to regard these procedural and policy changes as an opportunity, and then be able to take advantage of them, was influenced by HEI-wide characteristics rather than project- or even programme-specific characteristics. The most important of these characteristics are:

- *Management approach.* Cautious, risk-adverse management is characterised by internal approval processes limiting expenditure until allocation and in some cases acceptance of proposals is notified. This is in contrast to those HEIs that take a more balanced view of risk and will ensure approved projects are progressed on the basis of expected benefits not source of funding.
- *Economies of scale.* Limited economies of scale within the capital programmes limits flexibility to switch funding across projects within programmes. This is in contrast to HEIs that have sufficient scale in their operations to allow them to select the projects for HEFCE funding from a rolling programme.
- *Financial flexibility.* Limited financial flexibility is characterised by limited alternative or recurring capital funding sources. This is in contrast to HEIs that have built up cash reserves and or have access to affordable external financing. For these HEIs the source of funding is managed at an institution level and is largely separated from the project investment appraisal, since projects that generate real returns will attract internal or external funding.

The important point about these characteristics relates to the freedom of management to remove or reduce them as limiting factors. Generally, the last two characteristics of economies of scale and financial flexibility are structural and not easily effected in the short-term without HEIs accepting a marked increase in the operational and financial risk. The first characteristic however is to some extent self-imposed. Therefore if this is a limiting factor to accelerating benefits it could be argued that it represents a missed opportunity for institutions.

A final observation is that there were mixed levels of awareness of the HEFCE changes and what they meant, not only from one HEI to another but also within the same HEI. This meant there was often no single accurate and consistent view within an institution as to what the potential benefits could be. This does not help facilitate the responsiveness of HEIs to the changed capital arrangements.

Impact

Except for the most responsive HEIs, or those lucky enough to have had a project that coincided with the HEFCE changes and timetables, there was limited ability to take substantial advantage of the early start rules.

At the other extreme, HEIs that have adopted a fully strategic approach to management, have strong financial flexibility and a large rolling capital programme found the changes of minor significance, since the delivery of large complex and interrelated programmes are already operating to a perceived optimum time line.

It is important to ensure that communication from HEFCE is consistent and timely. This should also include ensuring that the different departments and particularly HEFCE staff that deal directly with HEIs are fully briefed on the changes and what they mean.

5.3 COST OF CAPITAL

Key Issues

Another angle on the project cost of capital benefit is the cash flow advantage resulting from draw-down of HEFCE funding earlier than before, and before other sources of funding are utilised. There is some evidence that HEIs are beginning to realise this benefit but at this stage there is little global data on the extent to which the sector has benefited from this change, given it is so early in the funding cycle.

Whilst it is likely that many HEIs will draw down some funds prior to April 2006, some institutions have limited flexibility to alter programmes, particularly if their capital programme is 90% funded by HEFCE.

> *The changes have delivered no impact on our cost of capital since we have very limited alternative sources of funding – the vast majority of capital funding is HEFCE sourced and therefore we do not have a capital programme that regularly competes for funding. The practical application of this is that funding dictates the project (rather than the other way round). Which ultimately means that our strategic plan is constantly in danger of becoming aspirational.*
>
> *Principal*

At the HEI and sector level it is too early to adequately assess the impact to the HEI cost of capital resulting from collective changes to the capital funding arrangements.

Impact

As mentioned above, there was some confusion amongst HEIs as to what the new rules mean in practice, again indicating scope for clarification.

We would also suggest a need to investigate further the relationship of cost of capital and funding sources, since there are some important inconsistencies in the way investment appraisal is conducted across the sector. For example, some institutions incorrectly include HEFCE capital funding in the benefits line of the NPV, whilst others do not. It is also noted that discount rates used vary: some use the Green Book rate, others use the cost of external bank debt, and others attempt to use their own weighted average cost of capital. Given that institutions are using different approaches to investment appraisal it may be worth institutions revisiting HEFCE guidance on investment decision making.[4]

[4] HEFCE 2003/17, 'Investment decision-making: a guide to good practice', April 2003.

6. FINDINGS AND CONCLUSIONS

6.1 SUMMARY OF FINDINGS

The assessment of benefits accruing to the HEIs resulting from the changed capital funding arrangements can be reported as:

- realised benefits
- unrealised or opportunity benefits.

Realised Benefits

Institutions have been able to reduce the cost of accountability in relation to the direct impacts on staff time and non-staff costs. We estimate that the savings realised by the sector amount to approximately £2.2 million each year as a result of the changed funding arrangements – equivalent to some 50% of the total direct costs.

Unrealised or Opportunity Benefits

The collective benefits of the changed arrangements provide the sector with an opportunity to translate greater certainty into actionable capital plans earlier than would otherwise be possible under the previous arrangements. The impact on institutions of being able to deliver these plans earlier will be to accelerate the realisation of the benefits.

The impact depends on the actual financial return of the total capital investment being brought forward, but this could plausibly amount to hundreds of million of pounds for the sector. While there is good evidence that many HEIs have used the changed funding arrangements to accelerate investment, few have yet been able realise any immediate benefit. A number of HEIs are not expecting to realise any benefit from the changes.

Overall, the potential value of these benefits is significant but cannot be substantiated with any certainty at this time because (a) the benefits will only accrue at later stages of an investment cycle that is just starting, and (b) the extent to which institutions actually realise the potential benefits is largely determined by their own management systems and investment strategies.

The impact of assuming future funding for planning purposes on the cost of capital presents the sector with a long-term opportunity to lower finance costs by £5 million to £7 million a year. However, qualitative data suggests that the relationship between planning certainty and HEI cost of capital is not well understood across the sector. To gain a reliable estimate of the impact on cost of capital an assessment would need to be conducted over a longer timeframe.

Our analysis into the changed capital funding arrangements can be summarised in Figure 9.

Figure 9: Impacts on HEIs of changed capital funding arrangements

Impacts on Higher Education Institutions	
Direct Impacts	**Indirect Impacts**
<u>Staff Costs</u> **1. Overall reduction of direct measured costs** **2. Predominantly a reduction in senior HEI staff time** **3. General trend to treat process as administrative rather than decision making but many HEIs still have some way to go** **4. Centrally managed submissions (top-down planning) required less overall time and effort than a democratic approach (bottom-up)**	**<u>Staff Costs</u>** **1. Lighter touch demands more of internal planning processes** **2. Opportunity cost of freeing up senior HEI management to focus on better planning** **3. Most significant driver of staff time required to administer the HEFCE funding process is the approach management take to capital investment planning per se**
<u>Non Staff Costs</u> **1. Changes have resulted in a reduction of non-staff costs** **2. Main reduction relates to the elimination of the mandatory audit following project completion** **3. Full impact of changes will only be truly known at the end of the funding cycle**	**<u>Non Staff Costs</u>** **1. General consensus that changes are welcome and are in the right direction** **2. The realisation of potential accelerated benefits cannot be fully assessed this early in the funding programme** **3. Propensity to (plan to) realise benefits depends on scale of capital programme and the options available to an HEI** **4. HEI cost of capital benefits to the sector are qualitative and can only be reliably measured over a longer period of time**

The collective impact on the sector of the changes to the capital funding are important, and a clear further step in the right direction since real benefits have been realised by institutions. The remainder of this report looks at HEFCE capital funding from the perspective of HEIs and what all this means for the capital funding framework.

6.2 CONSIDERATIONS FOR FUTURE CHANGES

During the course of the study we asked HEIs to comment on what they would regard as important considerations for any future changes to HEFCE capital funding. Figure 10 summarises the suggestions and provides a weighting to indicate the frequency that each suggestion was recorded. All suggestions were made by senior management within HEIs.

Figure 10: Summary suggestions from HEIs for future changes to capital funding

Suggestion		%
1	Single HEFCE cheque	**14%**
2	Allow carry forward and carry back	**11%**
3	Further simplification of returns	**11%**
4	Remove or ease spending deadline (2 yrs)	**8%**
5	Driving behaviour by formula should be removed	**8%**
6	Longer Term Funding Period (>2yrs to say 5 years)	**5%**
7	Allow advance funding of consultant costs	**5%**
8	Earlier announcement of allocations	**5%**
9	Greater certainty of further funding rounds	**5%**
10	Clearer communication of funding changes and expectations	**5%**
11	Waive 10% contribution requirement for partnerships	**5%**
12	Bring Academic and HEFCE funding calenders together	**5%**
13	Simplify FEC allocations process	**3%**
14	Funding assessment process to take account of track record	**3%**
15	Create a sustainable coordinated procurement programme	**3%**

We will not go into each of these, although it is worth exploring the top five suggestions.

Single Cheque (14%)

The single cheque from HEFCE was the most common request for change. It was suggested that SRIF and TLC capital grants could be combined into a single cheque with a single submission process. However, some took this further and suggested that the capital grants should be rolled up with all special-purpose grants into the recurrent student grants for teaching and learning. The institutions that suggested this cited the benefits as being greatly reduced administration, and an ability to tailor the allocation of grant income to the most appropriate area of HEI operations and so reduce opportunistic spending as a result of proposal-based funding.

HEFCE should seek to release those institutions that have a solid track record supported by strong management from the administration and multiple funding sources and write a single cheque.

PVC Resources

The key to this is whether HEIs' enthusiasm to self-manage grant allocation between teaching and learning and research, and between capital and revenue funding, matches management's track record in delivering appropriate value for money, and whether internal processes are sufficiently strong to manage risk effectively. It should be noted that a number of institutions actually liked the idea of separate funding. However this could suggest that these organisations do not have sufficiently robust internal controls to be able to ensure efficient resource allocation, and as a result rely on HEFCE to make these decisions for them.

Allow Carry Forward and Carry Back of Funding Allocation (11%)

This was suggested both by those institutions that were effective at delivering programmes, and therefore wanted the freedom to get on with the delivery on an accelerated basis (i.e. the carry back), and by those institutions that suffered problems of programme management and delivery (i.e. the carry forward).

> *We have a similar issue to HEFCE within our institution, where the centre controls budget allocations to the schools. However given the planning timetable we know that schools need continuity of spending approval and so we allocate them a percentage of their in-year budget to the following year to fill the immediate gap. This is a one-off exercise and once in place has no net financial effect year on year. Could HEFCE employ a similar system to allow greater flexibility and assist continuity?*
>
> *Finance Director*

Further Simplification of Returns

The changes implemented to date in terms of the submission process and the lighter approach were regarded as a good step in the right direction. However, there was still a feeling that some duplication continued to exist on the forms, and whilst a programme-level approach was encouraged there was still a need to break down equipment to its component parts. Although HEFCE has confirmed that this is intentional as the information is used to allow collaborative procurement to take place.

> *Still have to identify specific projects not simply an overall objective/outcome for the period. This inevitably leads to some additional analysis and cost.*
>
> *Head of Estates*

Removal or Easing the Two-Year Spending Deadline

This suggestion is partly linked to the second ranked suggestion, since they are both driven by a desire to have greater flexibility.

> *Difficult to take advantage of earlier spend window since design and feasibility comes first. This takes time (12-18 months for large projects) and is not immediately reimbursable by HEFCE.*
>
> *Director of Estates*

Large projects with a strategic impact do not happen in 2.5 years.

Director of Estates

Whilst it certainly appears true that large estates programmes take longer than two and half years, there is no consensus that the HEFCE spending limits cause undue concern. In many instances HEIs have embedded processes that enable simpler and more responsive control of their spending milestones for capital programmes. In these institutions delivery risks that could affect spending milestones are actively managed i.e. if one project within a programme is slipping then the draw-downs are swiftly re-profiled to another eligible project to ensure there is no risk of losing funding resulting from a missed milestone. The adjustment to the plan is accompanied by early communication to HEFCE and is actioned internally without the need for consensus among the university's management team.

Spending deadlines are not a major issue at present. Managing timelines is less of an issue with the large projects since they are centrally managed. It's the projects which have devolved responsibility to the faculties, e.g. equipment, where there are more issues, since there is a tendency to wait until the last minute to get the most up-to-date model and specification.

PVC Resources

Overall the picture is not clear, with different organisations appearing to interpret and act on the HEFCE rules in different ways. Some organisations see the HEFCE submission process as simply an administrative exercise and do not let it drive project planning or decision-making, whilst others seem to take a strict approach and therefore they find themselves facing reduced operational flexibility and feel that the tail is 'wagging the dog'. Clearly the situation is more complex than this, and is something we pick up on in the following section of this study.

Driving Behaviour by Funding Formula Should Be Removed

Several institutions commented on the implications of the current funding formula. Various concerns were expressed, ranging from the highly skewed nature of SRIF funding to the individual formulae across different disciplines within the TLC stream.

Spending by formula produces inequities. Certainly have no problems spending £1.8 million over 2 years. The benchmark for a teaching facility is £3 million. However the issue is more that the university can rarely find the other £1.2 million. So projects are often selected on what can be afforded rather than what is strategically right.

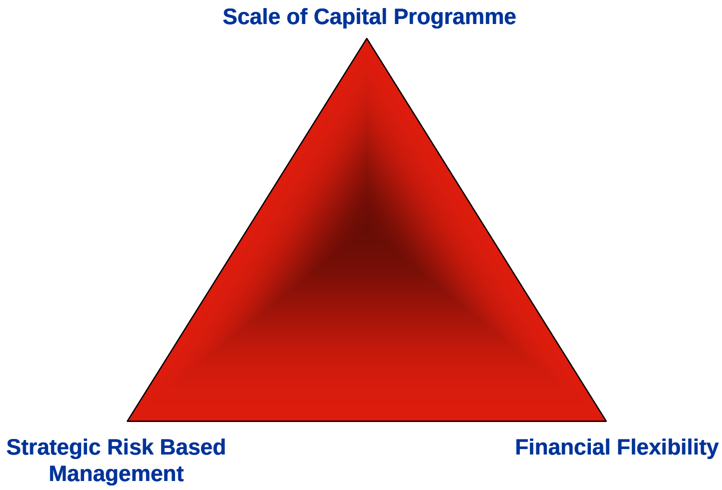
Principal

This is an area that goes beyond the remit of this study and is simply noted here as a subject where strong opinions exist and that is perhaps worthy of further study.

6.3 IMPLICATIONS FOR CAPITAL FUNDING FRAMEWORK

This study has estimated the financial benefits associated with the implementation of a collection of changes to the capital funding arrangements. It is clear that the relationship between HEFCE making changes to the capital funding process and the realisation of benefits is a complex one. We would certainly echo conclusions from earlier PA Consulting studies into costs of accountability, that much of an organisation's ability to realise benefits from changes in accountability requirements is influenced by management practice. In addition to this are several factors that have been recurring themes limiting or facilitating change, predominantly management's approach to risk, the financial flexibility of the HEI and the size of the rolling capital programme (see Figure 11).

Figure 5: Recurring themes driving realisation of benefits



During this study no structured analysis of where HEIs would fit was completed, the aim is simply to introduce a new way of looking at HEIs when considering future changes to capital arrangements. In using this model, we believe five broad types of institution can be defined. Figure 12 describes possible characteristics for each type together with a prediction of the ability of each type to take advantage of the changes to procedural and policy changes to HEFCE capital arrangements.

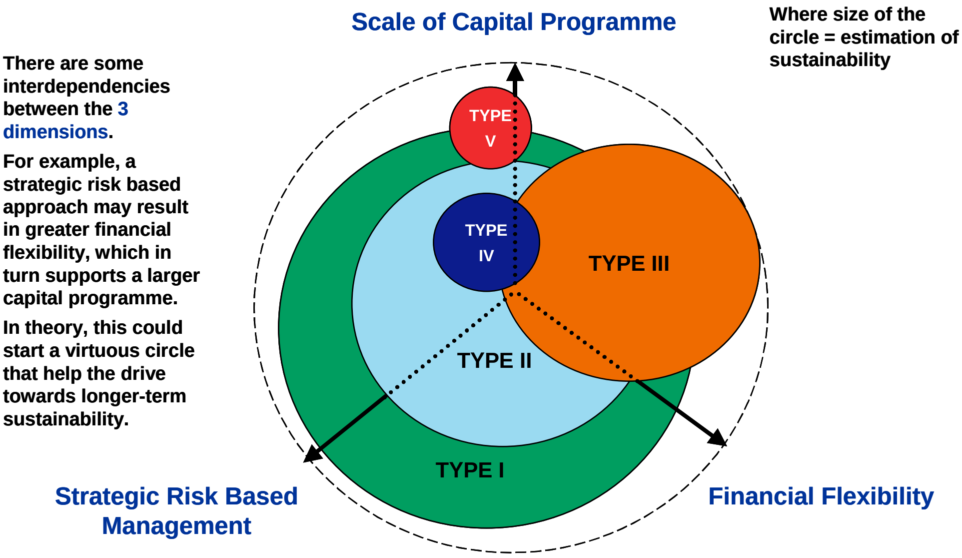
Figure 12: Ability of different types of HEI to take advantage of changes in capital funding

HEI Type	High Level Characteristics	Predicted impact of changes	Overall impact of changes
Type I	▪Strategic plan that includes capital programme direction setting and timelines ▪Market leading reputation in teaching and research that readily attracts funding – strong financial position	▪Due to scale and relative importance of HEFCE funding, changes likely to represent a marginal opportunity ▪More likely to see the submission process administrative rather than decision making in focus	**Limited (benefits already taken)**
Type II	▪Strategic plan that includes capital programme direction setting and some timelines ▪Risk based management approach rather than controlling – processes that allow creative solutions – external focus ▪Funding is a challenge – therefore there is an issue of scarce resources but rigorous in investment appraisal	▪External focus would have enable HEI to spot opportunities early ▪Flexible planning approach would assist in adapting plans to realise benefits	**Group most likely to value and be able to take advantage of changes**
Type III	▪Strategic plan but often without timelines – creating a more reactive environment ▪Tendency to focus on cautious / risk adverse management approach ▪Emphasis on strict processes that tightly control expenditure – internal focus	▪Internal focus may encourage a lower level of awareness of changes ▪ Strict internal processes would make it difficult to alter plans in a controlled manner – reducing responsiveness	**Some benefits, but could have been greater**
Type IV	▪Strategic plan – often with no timelines, opportunistic in planning ▪Very risk adverse since there is little margin for error ▪Low economies of scale – project rather than programme focused ▪Little in the way of other capital funding sources – other than debt	▪Low impact since projects generally would not even receive internal approval until final HEFCE approval received – therefore early starts and draw downs limited ▪Danger of long range planning being aspirational	**Limited**
Type V	▪Focus on cost control – marginal financial performance ▪Limited strategic planning – tendency to be reactive and opportunistic and plans prone to change ▪Capital programmes funded almost exclusively from HEFCE ▪Limited financial flexibility – low reserves, high debt financing	▪Project delivery issues and risks, limited alternative sources of funding and focus on cost control means that early start opportunities would be very limited ▪Focus on the short term horizons may limit ability to realise benefit from greater planning certainty	**Limited**

It is of course possible for an HEI to transcend more than one type, although it is very unlikely it could transcend more than two. This could be possible if capital programmes are split down further into property infrastructure and research equipment projects. It was seen that often very different processes govern these two types of capital programmes. For example, an HEI that transcends two types may find that property infrastructure projects are directly driven from a strategic plan, whilst pure research equipment projects may be overseen by a research strategy in which the process for identifying the projects is largely reactive and opportunistic in nature.

Using the same model we have mapped these types graphically (in Figure 13) providing a comparison of the different types of institution in relation to the three key themes.

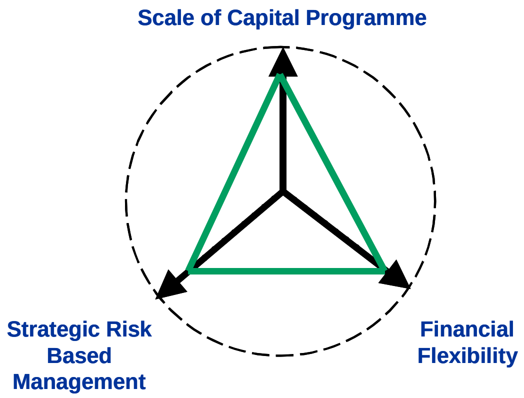
Figure 13: Potential Types of HEI



We could take this further since interestingly there are some interdependencies between the three dimensions. For example, a strategic risk-based approach may result in greater financial flexibility, which in turn supports a larger capital programme. In theory, this could start a virtuous circle that promotes the drive towards longer-term sustainability.

Whilst this an interesting new look at the impact of the changed capital funding arrangements, the real use of this type of analysis is being able to adopt a risk-based approach to funding arrangements. The following looks at how approaches could be focussed if this model was to be used.

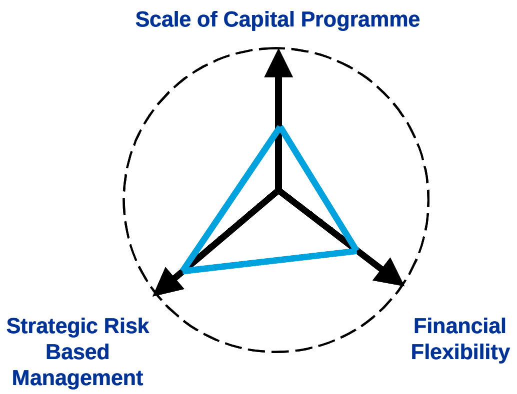
Type I



This type has a sound track record of delivering on its strategic plans and is supported by a governance structure following best practice.

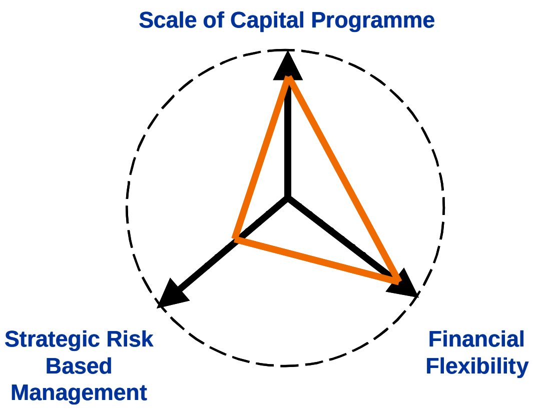
The focus for this type of institution would therefore be on ensuring this is sustainable. This could translate into strategy, performance and governance reviews, with limited detail on capital proposals. Grants could be paid annually in advance.

Type II



This type of institution would require little special monitoring, since it would be considered to be moving in the right direction in terms of adopting a progressive and strategic management approach, supported by appropriate governance and internal control frameworks.

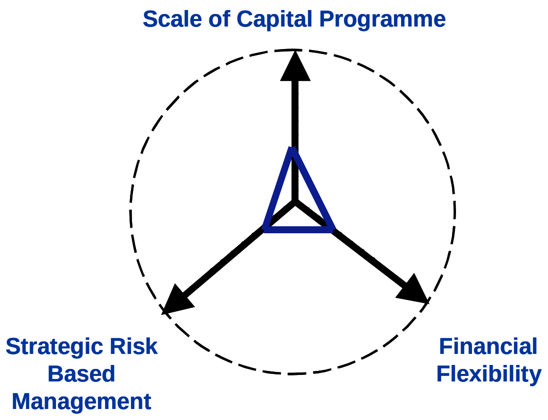
Type III



This type would probably prefer separate streams of funding so that distinct types of activities are supported e.g. research or maintenance. However, this approach is likely to lead to an inconsistent approach to strategic thinking and limited planning coherence since plans and activities are to a greater extent being driven by the specific funding pots.

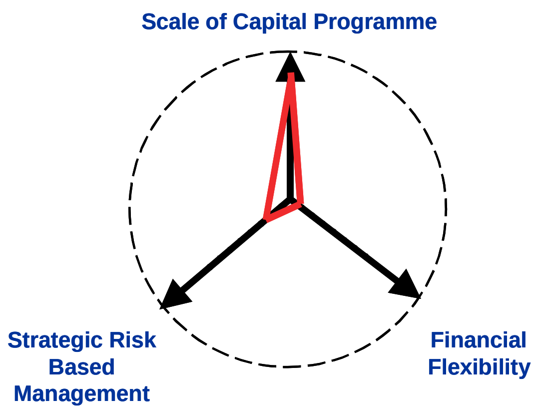
The focus for this type of institution would therefore be on ensuring plans are sustainable and joined up across corporate, research, estates and financial plans. Accountability requirements would also aim to encourage the further development of internal processes and best practice. Grants would be paid on profile to encourage disciplined planning and forecasting processes.

Type IV



This type has a limited capital programme and the tendency is to have an aspirational strategy, with key programmes to support it but often these programmes do not have dates attached since funding is very limited and is predominantly provided by HEFCE. While the importance of the HEFCE funding to these HEIs is higher, the risk to HEFCE of a £1-2 million funding line not achieving value for money is far lower than the potential risk associated with an HEI that received £10-20 million.

As we found in the earlier analysis of direct staff time and effort, there is a minimum amount of administration required regardless of project size. Since the process currently follows a 'one-size fits all' approach, the burden of compliance is relatively much higher for these typically smaller HEIs. Therefore the focus for this group would therefore be on reducing the level of accountability work in proportion to the level of risk.



*Type V*This type may have an inconsistent financial track record, and be experiencing high levels of change (e.g. management, operations and markets) at a greater level than the sector as a whole. It may also have significant imbalance within its plans (e.g. large unfunded capital programme requirements).

The focus for this type of institution would be on heavier overall involvement in strategic and performance reviews, together with a proposal submission requirement in line with the current process.

Moving forward

We believe that the concept of a risk-based approach to managing capital funding has some clear advantages:

- it encourages HEIs further to adopt a best practice and strategic approach to managing capital programmes that will ultimately lead to better and more coherent and effective decisions being made
- it provides HEFCE with a mechanism to focus time and effort on those institutions that require attention, allowing those institutions that are sufficiently robust and well managed to focus on managing their plans rather than managing a funding process.

There could be a number of pitfalls to this type of approach, such as preoccupation of HEIs as to which group they fall into, and the amount of additional work that could result from managing league tables and associated separate processes. Having said this, the additional effort would perhaps be justified if the development of this approach were applied to a broader range of HEFCE funding arrangements.

It is clear that many institutions have embraced good practice and started down the path of implementing sound approaches to strategic planning and corporate governance, together with effective control and information systems. However, it is also clear that all institutions have to continue to work hard to demonstrate that they can be benchmarked against best practice in other sectors and countries, particularly if they are ultimately going to be successful in lobbying HEFCE and Government for increasing self-regulation of their publicly funded activities.

APPENDIX A: CHANGES TO THE FUNDING CYCLE

	2003												2004			2004	2006	
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr-Mar	Apr-Mar	
Project Capital 3					Scheme announced, templates published AND allocations published					Deadline for submissions to HEFCE		**Confirmation of project allocations**				Start of funding period BUT would consider early starts	Projects complete and project capital fund spent (by 31 Mar 2006)	Audits
SRIF 2		Invitation, conditional allocations and templates published			Deadline for programme submissions to HEFCE		**Project funding announced**	Institutions confirm payment profiles to HEFCE								SRIF funds begin to flow on projects	SRIF round 2 closes; only retentions held by HEFCE will be paid after this date	Audits
								Funding may be available earlier for projects starting after August 2003										
								8 months early start										

	2005												2006			2006	2008	
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr-Mar	Apr-Mar	Sept
Combined T&L + SRIF	Conditional allocations and proposal process published				Deadline for programme and project proposals to be received by HEFCE		**Confirmation by HEFCE of acceptance of proposals**									Funding available	Capital programme ends	Deadline of receipt by HEFCE of project completion statements
							6 months (earlier allocation for T&L from 2004-06)											
				First start date for agreed early start projects														Sample audits
				12 months early start (4 months longer than 2004-06)														

Source: HEFCE Publications 2003/06, 2003/26 and2005/08

APPENDIX B: ABBREVIATIONS

FTE	Full-time equivalent
HEFCE	Higher Education Funding Council for England
HEI	Higher education institution
NPV	Net Present Value
SRIF	Science Research Investment Fund
TLC	Teaching and learning capital