February 2006/04

Core funding/operations

Consultation

Comments should be sent to HEFCE by Friday 28 April

This document sets out proposals for a new approach to capital investment for higher education institutions. These proposals are in advance of the 2007 Comprehensive Spending Review and are dependent on its outcome.

February 2006/**04**

Capital investment framework

Consultation on a new approach

HIGHER EDUCATION FUNDING COUNCIL FOR ENGLAND

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Capital investment framework
Consultation on a new approach

To	Heads of HEFCE-funded higher education institutions Heads of universities in Northern Ireland
Of interest to those responsible for	Governance, Management, Finance, Estates, IT
Reference	2006/**04**
Publication date	February 2006
Enquiries to	Ian Lewis tel 0117 931 7336 e-mail i.lewis@hefce.ac.uk

Executive summary

Purpose

1. This document sets out proposals for a new approach to capital investment in higher education. These proposals are in advance of the 2007 Comprehensive Spending Review and are dependent on its outcome.

Key points

2. Higher education institutions (HEIs) need to plan strategically and invest appropriately if their physical infrastructure is to remain fit for purpose in the long term.

3. In many cases this will require them to take a longer-term view of capital investment and funding and to develop a more strategic approach.

4. Such investment by institutions should be seen as contributing to achieving their long-term academic objectives; as such, capital investment should be integral to their strategic and operational systems.

5. Where HEIs are able to demonstrate that capital investment plans are integrated with their strategic and operational planning, and that investment is being made in accordance with those plans in order to sustain their physical infrastructure, we would consider providing capital funding more flexibly, monitored within the 'single conversation' between HEFCE and institutions.

Action required

6. Comments on the proposed new arrangements should be e-mailed to capital@hefce.ac.uk by **Friday 28 April 2006**.

Introduction

7. HEIs need to plan strategically and invest appropriately if their physical infrastructure is to remain fit for purpose in the long term. This is part of the broader issues of the long-term sustainability of higher education and its role in helping to deliver economic and social goals.

8. While the initial focus for capital funding has been to address past under-investment, the issue now is more about continuing investment by HEIs to secure long-term sustainability, using all their sources of funding. Such investment by HEIs contributes to achieving their long-term academic objectives, and as such, capital investment should be integral to their strategic and operational systems.

9. In many cases this will require HEIs to take a longer-term view of capital investment and funding and to develop a more strategic approach. This also needs to be seen as contributing to the long-term financial sustainability of higher education, as well as to the identification and recovery of the full economic costs of activities.

10. In this document we discuss the changes affecting higher education that mean we believe a different approach to capital investment is required for the future; assess the strengths and weaknesses of the current approach; set out what we are proposing; and invite your comments.

Present context

11. Earmarked capital funding has been provided through government spending reviews since 1998 to address past under-investment in higher education in England. The Government cannot make funding commitments that go beyond the latest spending review timescale. However, this should not prevent HEIs from taking a longer-term view of their capital needs, priorities for funding, and the mix of potential funding sources. This could include considering a range of scenarios to take account of alternative levels of funding.

12. Capital funding provided since 1998-99 (Figure 1) has enabled HEIs to increase their capital investment (Figure 2).

Figure 1 **HEFCE capital grants to English HEIs 1996-97 to 2007-08 (£M)**

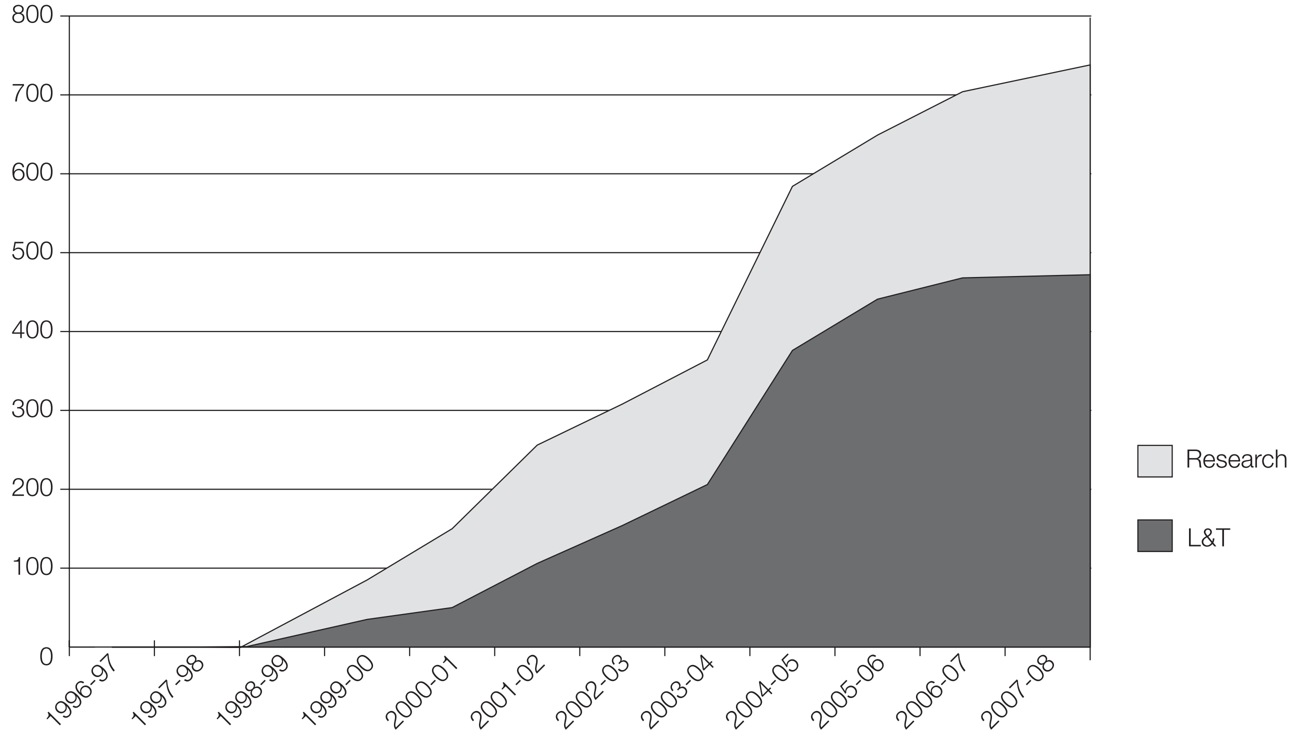
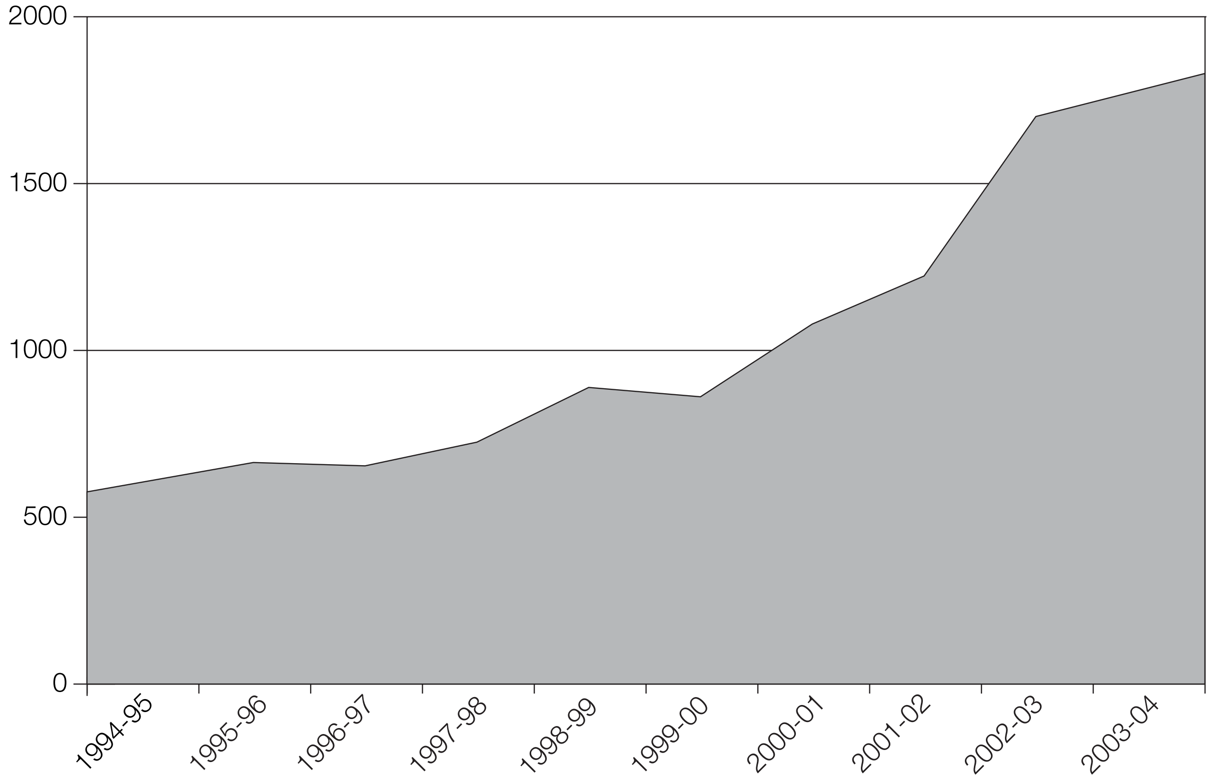


Figure 2 **Capital expenditure by English HEIs 1994-95 to 2003-04 (£M)**



13. There has been a substantial increase in actual capital expenditure, driven by the increasing level of capital funding. This demonstrates additionality: capital grants have led to increased capital expenditure rather than displacing expenditure previously funded from other sources. HEIs' financial forecasts provided to HEFCE indicate continuing capital expenditure, closely correlated to announced levels of capital funding[1].

14. However, these levels of capital expenditure and funding need to be viewed against the most recent (2002) estimates of £6,500 million of past under-investment, and the need to reinvest 4-5 per cent annually of the estimated £21,000 million value of the non-residential estate and to replace an estimated £6,500 million worth of equipment on a five to ten year cycle[2].

Changing context

15. Higher education is increasingly recognised for the contribution it makes to the economic and social development of the country. This entails HEIs engaging in a wider range of activities and responding to increased expectations and requirements from a wider range of stakeholders. Consequently sources of funding and income are becoming more diverse, and not all from public funds. The introduction of variable tuition fees for full-time undergraduates from 2006 will provide additional resources, and will further reduce the proportion of funding for HEIs coming from Government.

16. The increased awareness of the full costs of activities through the Transparency Review has reinforced the need for institutions to consider the

1 HEFCE analysis of 2005 financial forecasts (HEFCE 2006/01).

2 These data are from the studies carried out by J M Consulting for the OST, HEFCE and others as evidence for the 2002 spending review.

costs of physical assets as part of total costs. The costs of providing and maintaining buildings, equipment and supporting infrastructure are part of the costs of activities and need to be seen in that context. These costs also need to be recovered through funding and pricing mechanisms to avoid activities becoming financially unsustainable in the longer term.

17. HEIs will need to consider both the recurrent and capital funding provided for an activity when assessing the recovery of the full costs across all activities, in aggregate, and when determining their pricing policies.

18. A longer-term approach to capital investment is supported by techniques such as whole life costing, which requires more energy efficient and therefore environmentally sustainable buildings. We believe that this needs to be part of the broader context of higher education's contribution to sustainability, as set out in 'Sustainable development in higher education' (HEFCE 2005/28).

19. There is increasing recognition within Government and HEIs that activities need to be funded on a long-term sustainable basis, if higher education is to remain strong in increasingly competitive global markets. From September 2005, proposals submitted to the Research Councils are on the basis of full economic costs (and funding provided by the Research Councils is at the level of 80 per cent of full economic cost). In addition it is government policy that other government departments should pay for the research that they commission from HEIs on the basis of full economic cost.

20. The purpose of capital investment is to create and maintain the physical infrastructure that enables high quality learning and teaching, research and knowledge transfer to take place. This is a dynamic process, with re-investment taking account of changes in requirements and technological changes, so that the infrastructure remains fit for purpose. We need assurance that capital funding is properly applied to achieve this.

21. In the consultation document on our developing approach to accountability and risk (HEFCE 2005/31) we state that 'our vision is that institutions should have such excellent governance and management processes that they can easily demonstrate to their stakeholders, including HEFCE, proper accountability for the use of public funds. The better these processes, the lighter will be the burden of providing assurance.'

22. The demonstration of a strategic approach to capital planning and the delivery of investment plans will contribute to increasing our confidence in institutional governance and management arrangements. As a consequence we would be able to reduce the accountability requirements placed on HEIs with no increase in the risks to the proper use of public funds.

Consultation question 1

Do you agree that the focus of capital investment by HEIs should be on the long-term sustainability of their physical infrastructure?

Consultation question 2

Do you agree that HEIs should be expected to plan such capital investment as part of their strategic and operating planning processes?

Current approach: strengths and weaknesses

23. The strengths of the present capital funding arrangements can be summarised as follows:

a. Funding is distributed by formula as a conditional allocation (subject to HEIs submitting acceptable proposals to HEFCE showing how they will use the money). This method is open and transparent and not seen as a burden by institutions.

b. The levels of capital funding are clearly identifiable.

c. There are separate allocations of capital funding for research, and for learning and teaching, so there is a clear identification of investment in research to support the research base.

d. We require contractual commitment information as the trigger for funding, and link payments to expenditure profiles, so grants are not paid in advance of need.

e. Project completion statements provide evidence of delivery, and assurance that public money is being used for the proper purposes.

f. We require HEIs to use collaborative arrangements when procuring equipment. The savings achieved are then reinvested by institutions.

24. The main weaknesses of the present capital funding arrangements are:

a. Capital funding is provided on a limited fixed-term basis, which does not sufficiently encourage long-term planning or optimal use of resources.

b. In many instances HEIs wait until capital funding is announced before deciding how it is to be used. This leads to delay and slippage against the fixed funding timescales.

c. The present arrangements risk distorting HEIs' priorities. Using the language of economics, HEIs should be better able to determine their best mix of the factors of production. They should then be held accountable on outputs and on strategic measures of sustainability. This will lead to better decisions and better value for money than an approach constrained by centralised decisions.

d. Currently we provide separate funding for research and for learning and teaching capital. This carries the risks that HEIs plan their requirements in a compartmentalised way, so that the underlying supporting infrastructure may not be fully considered or adequately funded.

Proposals

25. We are seeking, through this document, to encourage all HEIs to be able to demonstrate how they will sustain their physical infrastructure as an integral part of their strategic and operational planning processes. Where this is evidently the case we would wish to provide capital funding in a more flexible way, in support of capital investment plans.

26. We would wish to work with the sector representative bodies to determine how requirements to invest in the capital infrastructure can be properly incorporated into strategic and operational planning processes. This would include assessing:

- the processes within HEIs to integrate such requirements within their strategic and operational planning systems
- how these demonstrate that the levels of capital investment would achieve long-term sustainability of the infrastructure
- how actual capital investment would be monitored against the strategies.

Strategic planning

27. A number of HEIs already have a strategic approach to capital planning and funding. Here capital investment is seen as an integral part of their strategic and operational planning systems and processes. Assumptions are made about future levels of capital grants (as part of the overall funding for capital programmes) and plans are revised, if necessary, in the light of actual funding announcements.

28. In such cases, HEIs have determined where they need to invest to deliver their academic objectives and are not just reacting to identify how capital funding could be spent once it is announced. They are also considering their capital requirements in the round, that is across all activities and areas that require investment.

29. It is clearly beneficial for all HEIs to operate with this more strategic, proactive and long-term focus. In a climate of increased uncertainty there is a greater need for planning and for looking ahead, if risks are to be identified and managed.

30. Public funding announcements operate within the constraints of spending review timescales, but this is not a barrier to HEIs planning for the longer term. Within such planning, they should be able to establish their infrastructure needs and funding requirements, along with priorities and actions

under different scenarios. HEIs' forecasts of the capital investment required to sustain their physical infrastructure would also be valuable evidence to inform future spending reviews.

31. Where HEIs have not demonstrated a strategic approach to capital planning, or where plans were not satisfactory, we would continue to require the more detailed information as for the 2006-08 capital programmes, and funding would be provided on the same basis and in accordance with the existing terms and conditions. However, we would expect all HEIs to be able to take advantage of the new arrangements from April 2008, which will be subject to the outcome of the 2007 Comprehensive Spending Review.

Consultation question 3

Do you agree that HEFCE should work with sector bodies so that all HEIs are able to demonstrate a strategic approach to capital planning by April 2008? How might this be achieved?

Increasing flexibility

32. Currently there are specific time limits for the use of capital funding. These deadlines can constrain the optimal use of that funding as HEIs are driven to use the money by those deadlines rather than focusing on how to secure best value and their own academic objectives. Where institutions have developed a strategic approach to capital investment planning that addresses the issues set out above, we would look to provide capital funding on a profiled basis, with HEIs being able to spend the funds over more than one year. This flexibility would assist with large capital projects that run over a number of years. Such increased flexibility would be linked to HEIs continuing to demonstrate that they were investing to ensure the long-term sustainability of their infrastructures.

33. The Government's science and innovation investment framework states[3]:

> 'The Government is keen to encourage more holistic capital investment and planning. To this end, HEFCE will be discussing with institutions the merits of rolling the present research, teaching and IT capital funding streams into one, and the Government stands prepared to consider this possibility if it has the potential to improve investment decisions in universities (and colleges).'

34. However, this is not a straightforward process and we would need to discuss and agree with our funding partners and with sector bodies how we might address a number of issues, including:

a. How to demonstrate that separate funding provided for research and learning and teaching infrastructure was being invested appropriately.

b. The basis of the formulae to be used.

c. The inter-relationship with full economic costing.

35. Once these issues have been resolved satisfactorily, and where HEIs have developed a strategic approach to capital planning, we would consider providing capital funding as a combined capital stream. Such increased flexibility would also be linked to HEIs continuing to demonstrate that they were investing to ensure the long-term sustainability of their infrastructures.

Consultation question 4

Do you have any comments on the proposed changes to how capital funding could be distributed?

3 'Science and innovation investment framework 2004-2014', HM Treasury, 2004, paragraph 3.61.

Monitoring

36. A strategic approach to capital planning by HEIs is not in itself sufficient to provide the necessary level of assurance that the sector's physical infrastructure is being maintained in a fit state for the long term. We would need to monitor delivery against institutions' investment plans to ensure that these remain on track and that action is taken where such monitoring raises concerns. However, we would use existing data wherever possible and would look to incorporate our monitoring requirements within the proposed 'single conversation' (see HEFCE 2005/31).

37. The monitoring against institutions' capital investment plans would need to rely on strategic controls (such as trends in and actual levels of capital expenditure, the results of condition surveys of estates, and spending on maintenance). There are three main sources, which are considered in detail below:

a. Inclusion within existing financial data returns.

b. Metrics developed by the Research Base Funders' Forum, a group set up the Treasury to allow governmental and non-governmental funders of research to consider the collective impact of their strategies on the sustainability, health and outputs of the research base.

c. Estates management statistics and self-assessment.

Inclusion within existing financial data returns

38. HEIs currently provide information on their financial results in the Finance Statistics Return to the Higher Education Statistics Agency (HESA). The present data requirements could be modified to include data on actual capital expenditure against the investment plans.

39. In addition institutions provide HEFCE with five-year financial forecasts each year. Again the data within these could be modified to include projections of capital expenditure against the HEIs' infrastructure strategies and plans. These could be compared with the existing investment plans and provide early warning of any significant changes.

40. HEIs also provide HEFCE with the annual Transparency Review data return which reports on the full economic costs of activities. This is retrospective for the last completed year, but provides data on both absolute levels and trends in the recovery of full economic costs across all activities.

Metrics developed by the Research Base Funders' Forum

41. The Financial Sustainability Sub-Group of the Research Base Funders' Forum has identified four components of what it calls 'adaptive capacity': operating margins, people, equipment, and buildings.

42. The sub-group has identified 16 trigger metrics (listed at Annex B) which cover these four components of adaptive capacity. They are not intended to give a comprehensive picture of adaptive capacity but rather to prompt challenge if any of them appears to be at variance with an institution's account of its sustainability. There is also a wide range of existing data at institutional and sector levels which we could draw on to inform assessments of sustainability.

43. Establishing a standard set of metrics for each HEI will provide a basis for benchmarking between institutions which, in the absence of quantifiable norms, would provide them with helpful pointers towards good practice. Wherever possible, existing data sources would be used.

44. Given that most of the components of adaptive capacity evolve over periods longer than one year, it is essential that all the metrics proposed should be routinely considered as trends. In all cases, the direction and scale of change is likely to be more significant than the absolute values of the metrics in any year. The proposed set for each of the components is essentially measuring 'capacity', rather than the more familiar aspects of performance such as efficiency. The metrics that relate to the physical infrastructure are numbers 9 to 14 inclusive: all of these can be obtained from existing data, so the burden on HEIs would be minimal, except where the trigger metrics show an adverse trend.

Estate management statistics and self-assessment

45. At present most HEIs provide estates management statistics (EMS) data annually (see HEFCE 2004/45). This includes information for the previous year on both absolute levels and trends in key estates data, and the condition of the estate. Where HEIs do not currently provide EMS data (as participation in the project is voluntary) then there would be an additional requirement for them to meet. For those that do provide data, it will be up to them whether they are content for us to use EMS data or to supply the information separately.

46. A further element here could be commitment by HEIs to continuous improvement. One method may be through self-assessment. A toolkit for this purpose has been developed in collaboration with the Association of University Directors of Estates (AUDE). HEIs may choose to use the AUDE toolkit though we would recognise other approaches that work equally well.

47. In addition we would expect HEIs to identify how and when they would address any remedial actions arising from the self-assessment, and to set out how and when they would repeat the self-assessments to measure their own progress.

Actions should monitoring cause concerns

48. If monitoring through any of these routes raised issues we would discuss them with the HEIs concerned. This would be to establish first whether there was a genuine issue to be addressed and, if so, what action was to be taken, by whom and when.

49. If actions were required by the HEIs we might ask them to revert to providing more detailed information as now for the 2006-08 capital programmes. Funding would be provided on this basis and in accordance with existing terms and conditions.

50. When the trigger metrics indicated that the causes of the concern raised through monitoring had been addressed, the HEIs would be allowed to move back to the new approach.

Consultation question 5

Do you agree that the monitoring of actual capital investment by HEIs should form part of the 'single conversation' between HEFCE and institutions?

Responding to this consultation

51. Annex A provides a summary of the strengths and weaknesses of the current approach to capital funding and how we believe these proposals retain the strengths but address the weaknesses.

52. Responses to this consultation should be e-mailed to capital@hefce.ac.uk by **28 April 2006**, using the form at Annex C. The form can be downloaded from the web, with this document at www.hefce.ac.uk under Publications.

53. We will publish an analysis of responses to the consultation. Additionally, all responses may be disclosed on request, under the terms of the Freedom of Information Act. The Act gives a public right of access to any information held by a public authority, in this case HEFCE. This includes information provided in response to a consultation. We have a responsibility to decide whether any responses, including information about your identity, should be made public or treated as confidential. We can refuse to disclose information only in exceptional circumstances. This means responses to this consultation are unlikely to be treated as confidential except in very particular circumstances. Further information about the Act is available at www.informationcommissioner.gov.uk

54. In preparing this document we have focused on consulting on what we see as the major issues. There may well be other issues which we have not considered, or you may wish to make comments that are not directly related to any of the questions so far. We would be happy to hear them.

Annex A
Retaining strengths and addressing weaknesses

We believe that the proposals in this document address the weaknesses of the present approach to capital investment, without losing the strengths.

Strength of current arrangements	How this is retained
The conditional allocation basis is open and transparent and not seen as a burden by HEIs.	A conditional allocation basis would continue.
The levels of capital funding are clearly identifiable.	Any new capital allocations would continue to be announced separately alongside recurrent funding: they would not be merged.
There is a clear identification of investment in research to support the science base.	Capital allocations could identify the minimum amount to be invested in the science base. Monitoring of actual capital spend would identify if such investment was taking place.
We require information on contractual commitments as the trigger for funding, and link payments to expenditure profiles, which ensures that funds are not paid in advance of need.	Monitoring of actual capital expenditure, taking one year with another, would identify any significant slippage of payments ahead of plans.
Project completion statements provide evidence of delivery, and assurance of the proper use of public funds. A sample is selected for audit.	Assurance would be achieved through demonstrating that there is a strategic approach to capital planning and what is expected to be achieved through investment plans. Monitoring is to ensure delivery. Assurance would focus on outputs rather than inputs.
We require institutions to use collaborative arrangements for procuring equipment; and any savings are reinvested by the HEIs.	These benefits would be secured through existing, parallel activities to further improve collaborative procurement in higher education.
Other providers of capital funding receive assurance that their funding is used only for the intended purpose, by funding being allocated separately.	Data collected would still be able to provide this assurance (for example to the Office of Science and Technology about the level of investment in the research base).

Weakness of current arrangements	How this is addressed
Capital funding is provided on a limited, fixed-term basis which does not sufficiently encourage long-term planning or optimal use of resources.	We would give HEIs flexibility to apply capital funding for projects that cut across years, providing that they demonstrated a strategic approach to capital investment planning.
HEIs wait until capital funding is announced before deciding how it is to be used.	HEIs would be required to demonstrate a strategic approach to capital planning, with actual capital expenditure monitored against their capital investment plans.
The present separate funding streams (for research and for learning and teaching and IT capital) carry risks: that HEIs plan their requirements in a compartmentalised way, and that the underlying supporting infrastructure is not fully considered or adequately funded.	Capital investment plans would need to cover all capital investment, including supporting infrastructure, if they are to be accepted. Monitoring of actual capital expenditure would identify if capital investment is in accordance with the plans.

Annex B
Trigger metrics

Metric		Data source
1	Operating surplus/(deficit) adjusted by full economic costs (fEC) net adjustment from data through the Transparent Approach to Costing (TRAC).	Operating surplus/(deficit) taken from HESA financial return. fEC adjustment taken from the annual TRAC return.
2	Underlying operating surplus/(deficit).	Underlying adjustment taken from the annual accounts return that HEIs make to HEFCE.
3	Gearing ratio – total long-term borrowings/total general funds.	Figures entered on HESA return (reference Table 2 items 7ii, 11ii and 12iv).
4	Liquidity ratio – number of days ratios of cash and short-term investments to expenditure (less depreciation).	HESA return (reference Table 1 items 11 & 9 plus Table 2 items 3iii, 3 iv & 4iii).
5	Total income per full-time equivalent (FTE) academic.	Academic FTEs taken from HESA staff return. Total income from HESA financial return.
6	Research income per FTE academic.	Research income from HESA financial return (Table 5b item 3).
7	Average age of permanent academic staff.	HESA staff return.
8a	Total value of externally sponsored research.	HESA financial return (Table 5b item 3).
8b	Externally sponsored research as a percentage of total income.	HESA financial return.
9a	Total actual capitalised expenditure on equipment.	HESA Table 7 line 2c (column 1 total actual spend).
9b	Total actual capitalised expenditure on equipment as a percentage of the balance sheet value of equipment.	Net book value of equipment taken from the annual accounts. (Due to inconsistencies in the disclosures we have used tangible fixed assets excluding land and buildings as the 'equipment' figure.)
10	Total expenditure on major and minor works (capital).	HESA finance return (Table 7: Capital expenditure lines 2a and 2b of column 1 'total actual spend').
11	Total expenditure on repairs and maintenance (recurrent).	HESA finance return (Table 6 item 4 'premises' – line 4d of column 4 'other operating expenses').
12a	Proportion of building condition (percentage of gross internal area, GIA) in condition C and D[4].	EMS return – (D20a – total of residential and non-residential).
12b	Cost to upgrade buildings in condition C and D to condition B.	EMS return – (D20b – total of residential and non-residential).
13	Proportion of building space (GIA) with poor functional suitability (Grade 4)[5].	EMS return – (D21 functional suitability percentage GIA suitability grade 4 C13 – total of residential and non-residential).
14a	Total GIA.	EMS return (D11 gross internal area C1 total).
14b	Total income per square metre.	Total income per HESA return with area as per metric 14a.

4 Building condition C is defined as 'operational, but major repair or replacement needed in the short to medium term (generally 3 years)'. Condition D defined as 'inoperable, or serious risk of major failure or breakdown'.

5 Grade 4 building is defined as one that 'fails to support current functions and/or is unsuitable for current use. The operational problems associated with such space are major, and are constraining current functions in the space'. Definitions taken from EMS definitions 2004.

Annex C
Issues for consultation and response form

An electronic version of this form is available with the main document, HEFCE 2006/04, on the web at www.hefce.ac.uk under Publications. Completed forms should be e-mailed to capital@hefce.ac.uk no later than **Friday 28 April 2006.**

We will publish an analysis of responses to the consultation. Additionally, all responses may be disclosed on request, under the terms of the Freedom of Information Act. The Act gives a public right of access to any information held by a public authority, in this case HEFCE. This includes information provided in response to a consultation. We have a responsibility to decide whether any responses, including information about your identity, should be made public or treated as confidential. We can refuse to disclose information only in exceptional circumstances. This means responses to this consultation are unlikely to be treated as confidential except in very particular circumstances. Further information about the Act is available at www.informationcommissioner.gov.uk

Name ....

☐ Individual response

☐ Response on behalf of (name of institution or organisation)

....

Consultation questions

1. Do you agree that the focus of capital investment by HEIs should be on the long-term sustainability of their physical infrastructure?

2. Do you agree that HEIs should be expected to plan such capital investment as part of their strategic and operating planning processes?

3. Do you agree that HEFCE should work with sector bodies so that all HEIs are able to demonstrate a strategic approach to capital planning by April 2008? How might this be achieved?

4. Do you have any comments on the proposed changes to how capital funding could be distributed?

5. Do you agree that the monitoring of actual capital investment by HEIs should form part of the ‘single conversation’ between HEFCE and HEIs?

6. Do you have any other comments?

List of abbreviations

EMS	Estates management statistics
fEC	Full economic costs
FTE	Full-time equivalent
GIA	Gross internal area
HEFCE	Higher Education Funding Council for England
HEI	Higher education institution
HESA	Higher Education Statistics Agency

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