The impact of cuts on capital investment

Background

The University of Hertfordshire, like many other institutions in the Higher Education sector, is in a robust financial position, with cash reserves of £45m in July 2012 and healthy surpluses in 2010/11 (£10m) and 2011/12 (£17.7m). However, according to a report in The Times Higher in March 2013, the sector's strong financial position has led the Treasury to believe that universities are "awash with cash" at a time when it needs to cut spending for 2015/16. This view is mistaken. The following case study will show that:

- The University of Hertfordshire has an estate that relies on buildings from its technical college and polytechnic years, which are costly to run. Therefore, a ten-year, £400m programme of capital investment has been planned to address these challenges.

- The university must make large surpluses in order to invest in its estates vision, as capital funding from the government is limited.

- Surpluses are being driven through efficiency gains in non-staff costs as part of a long-standing business-facing mission.

- The university will not be able to maintain the level of surplus required to fund the capital investment programme if significant funding cuts are announced in the June spending review.

- The LEK report '*Construction in the UK economy'* (2009) found that for every £1 spent on construction, £2.84 is generated in economic activity (i.e. GDP increase). Funding cuts will therefore negatively impact the wider economy.

2020 estates vision

Our 2020 estates vision comprises the estates strategy and planned capital projects we have in place until 2020. The University of Hertfordshire was first established in 1952 as a technical college. Whilst it has changed beyond all recognition in most respects, the university's original campus still relies on a number of buildings from its technical college and early polytechnic years. This poses a number of problems:

- Out of those who wish to do so there is only capacity to accommodate half of our first year undergraduates in our on-campus halls of residence. Evidence from our i-barometer surveys shows that students living on campus enjoy a higher quality of life and have a better university experience.

- There are a number of old buildings, such as the halls of residence, which are extremely expensive to run and emit high carbon emissions (the university incurs circa £300k per annum in carbon tax).
- Critically, the university is committed to offering high quality science and engineering programmes, but the buildings in the science and engineering schools are in poor condition.
- The advent of higher fees has resulted in greater demand for better quality facilities. Student-facing services such as welfare, careers and placements, and the Students' Union, are distributed at locations across the campus. This is a poor use of space, but also means that there is no central on-campus hub where students and staff can socialise and meet. This is important in fostering a sense of 'belonging' to the university and making it a more attractive place to be.

In order to combat these issues, the university determined an estates masterplan in 2010. This plan outlines a strategic programme of capital projects for the next ten years, which amounts to circa £400m investment in the university's estate for which no significant borrowings would be required. The key projects are outlined below.

1. Developing halls of residence

The most significant capital project is the development of the halls of residence. This will be delivered over three phases and involves:

- Demolishing around 1,000 existing rooms
- Refurbishing around 500 existing rooms
- Building around 2,500 new rooms
- Developing new social spaces within the halls of residence complex, which will include two new sports pitches, a new gymnasium and six common rooms with informal learning and social spaces.

2. Improvements to teaching and research facilities

These improvements include:

- Refurbishment of the main building and the new lecture theatre on the College Lane campus
- A new science building
- A new engineering building
- A new teaching building.

3. Improvements to the campus

This element of the plan covers:

- Improvements to informal learning and social spaces
- Development of a student zone and hub, creating one central location for all student-facing services.

Sources of funding

The 2020 estates vision represents an investment just shy of £400m in the university's capital infrastructure. However, the university does not want to put its financial stability at risk by borrowing significant sums of money, in line with HEFCE's advice to the sector. Cuts in the Funding Council's capital funding stream mean that the university will receive very little money directly from the government (we estimate £8m) for capital projects over this decade. We have, therefore, had to explore alternative solutions, which are detailed below.

1. Residences – Public-Private Partnership

A joint venture, Uliving, has been established to fund the residences programme and release a capital receipt to the university for funding other capital projects.

- The joint venture will invest circa £190m. The majority of this funding will come from a capital markets bond (c£140m), with the balance coming from investors in the project (c£40m). Included in this is an investment from the university (c£6m).
- The funding will be raised from student rental income and the joint venture will be granted a 50-year lease to operate the accommodation. The funding will be off-balance sheet for the university in accounting terms.
- The capital receipt will help fund the new teaching and research buildings as well as on-going requirements to invest in teaching.

2. Surplus

The 2020 estates vision also requires the university to invest £204m from its cash reserves. Therefore we need to achieve an annual operating surplus of £10-£15m up to 2020/21 in order to:

- Complete the non-residences capital building projects, as outlined in the 2020 estates vision
- Demonstrate to bond-holders that the university is financially stable and will not materially increase its borrowing in the long-term.

Efficiencies

In order to achieve annual surpluses the university reduced non-staff 'back office' costs. This approach has since been recommended by the Diamond Review of *Efficiency and Effectiveness in Higher Education*. Efficiencies included: stronger communication between our finance department and academic schools and professional units, a simplification of processes, reduced duplication and stopping the fragmentation of supplies and services.

The large surpluses that the university made in 2010/11 and 2011/12 were due, in part, to the university saving £3.5m from new and renegotiated contracts. The university's approach has been to consider a) whether there is a different way we could purchase items and b) whether a service can be delivered differently at a lower cost without impacting upon service delivery. Two examples (of many) are outlined below.

1. Cleaning contract

In the past, the university contracted a company to clean the campus overnight, 365 days a year. In 2011, the university changed its cleaning contract so that, instead of an overnight service, the campus was cleaned between 5-8am, with regular spot-checks throughout the day. This change not only led to a significant cost reduction but also to an improved service delivery, with the introduction of a strict performance measurement system. This change in the cleaning contract contributed to a total saving of £910k in the Department of Estates 'soft services' (waste management, cleaning, grounds maintenance etc.) budget.

2. Southern Universities Purchasing Consortium

The university has also saved significant sums from being a member of the Southern Universities Purchasing Consortium (SUPC), which is chaired by our Secretary and Registrar, Philip Waters. The SUPC was formed in 1974 when a handful of universities came together for the collaborative purchase of stationery. It is now the largest of the six regional higher education purchasing consortia that operate throughout the UK and has a membership of over one hundred higher and further education institutions. The SUPC offers its members a wide range of collaborative purchase agreements covering most commodity areas. Over the last two years, new savings of over £1.2m per annum have been achieved by using SUPC contracts.

Conclusion – the impact of funding cuts

On the face of it, the university has a healthy balance sheet. The accounts show that the university has a £45m cash reserve and plans to have £10m surpluses each year until 2020. The reality, however, is that the university's budget is incredibly tight. A £10m surplus represents circa 5% of income, so a small negative change to income streams can have a serious knock-on impact on the institution's capacity to invest. The university's income streams are being put under pressure in a number of ways:

- The reforms to HEFCE student number controls for home students and the restrictions placed on student visas for international students mean that there is great uncertainty over student recruitment. For example, if we recruited 500 fewer international students next year, our surplus would be halved, unless costs were reduced elsewhere (not viable unless core services are reduced).
- There are a number of costs that are increasing/have increased as a result of changes to policy, which include: our National Scholarship Programme and Office for Fair Access commitments, pensions auto-enrolment, the increase to employers' NI contributions as contracting-out is phased out, and the 20% rate of VAT.

- When our fees reach £9k in 2016, there will no longer be any capacity to account for inflation for UK/EU undergraduates.

Therefore, reductions in funding from the government in the 2013 spending review would create another obstacle in our efforts to achieve surpluses that are of a sufficient size to enable us to invest in our estate. Funding streams that the government could cut in 2015/16 include funding for widening participation and the additional costs associated with teaching laboratory-based subjects (HEFCE's band B). The university receives around £3.8m for the 'student opportunity' fund (widening participation) and £9m for its band B (laboratory-based, physics etc.) subjects annually. Considering the efficiency savings already made, funding cuts would make it virtually impossible to achieve the level of surpluses required to fund our capital programme, unless the university further reduced spending on core services, which in turn would materially impact the student experience. The university would have two options:

- Carry on with the capital programme in full but cut the university's investment in teaching and learning. This would mean larger class sizes – resulting in poorer National Student Survey scores, and a fall in league table position a likely consequence.
- Reduce the level of capital expenditure and maintain an estate that continues to have the problems identified in the '2020 estates vision' section. This would affect the regional economy. The LEK report, *Construction in the UK economy* (2009) found that for every £1 spent on construction, £2.84 is generated in economic activity (i.e. GDP increase).

Given these two unpalatable options, the university would choose the second. The effect a cut in core services would have on the reputation of the institution, and its ability to recruit students from home and abroad in the short term, would not be acceptable. Therefore, reductions in funding will directly impact on the university's capital spending – and the wider economy.

About the University of Hertfordshire

As the leading business-facing university in the UK, the University of Hertfordshire is focused on developing new and creative approaches to learning, teaching and research with a commitment to adding value to employers, enterprise and regional, national and international economies.

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