

## Monitoring financial sustainability - HEIs

### Purpose

- 1 To provide the Funders' Forum with an update on the funding councils' assessment of institutions' sustainability.

### Background

- 2 This is the second substantive report on our assessment of institutions' sustainability following the approval of the methodology by Funders' Forum and HM Treasury in spring 2005. There are two elements to the monitoring arrangements: forward looking 'institutional frameworks towards achieving long-term sustainability' and a related set of historical 'trigger metrics'. Further information is provided in **Annex A**.
- 3 The Funders' Forum received a report on the funding councils' initial assessment of institutions' sustainability in April 2006 and accepted the recommendations of the report. An update of that report was received in April 2007.

### *Frameworks*

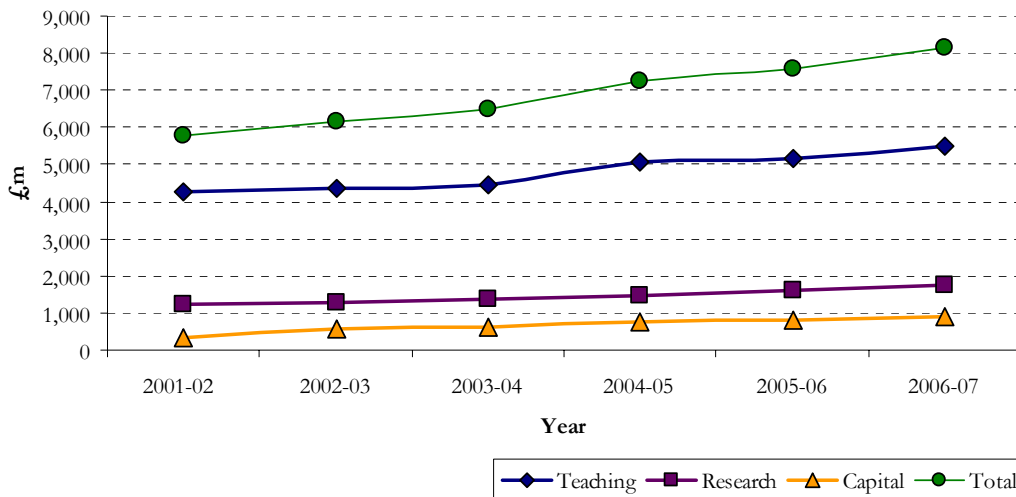
- 4 Institutions were asked to embed and update their frameworks as part of their own strategic planning processes and timetables.

### *Trigger metrics*

- 5 A list of the metrics is provided at **Annex B**. The data has now been extended to include 2005-06 data and 2006-07 data where available.
- 6 Detailed commentary on the trigger metrics is provided in **Annex C**. We have, again, limited our presentation of our analysis to the TRAC groups A and B (accounting for some 90 per cent of total research income) along with the sector average. Background information on these groupings is provided in **Annex A**.

## Funding context

Graph 1 - Funding Councils' grants 2001-02 to 2006-07 (real terms)

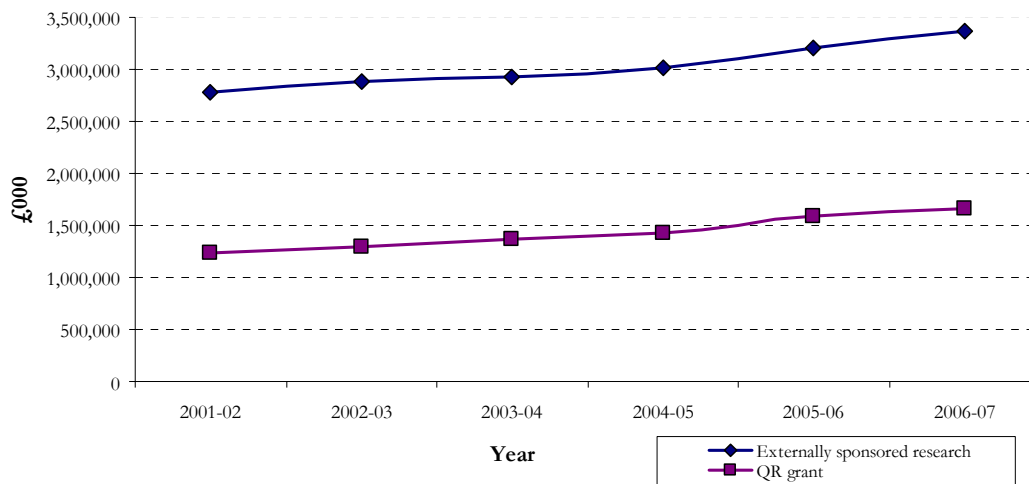


- 7 Graph 1 shows the level of funding council grant that the sector has received over the six-year period of the metrics in real terms. Capital grants include the funding provided to institutions from the both the Joint Infrastructure Fund and its successor the Science Research Investment Fund (SRIF).

## QR grant and externally sponsored research income

- 8 The findings of the 2002 report 'Investing in innovation: A strategy for Science, Engineering and Technology' indicated a widening gap between growth rates in QR and externally sponsored research between 1988-89 and 1999-00. Graph 2 shows that growth rates are still equalising in the period 2001-02 to 2006-07 and continues to support the high level view that institutions have stabilised the 'trading ratio' between QR and project funding.

**Graph 2 - Total sector externally sponsored research & main QR grant expressed in 2006-07 values**



**fEC**

- 9 The Research Councils provided additional funding of £120 million per annum from 2005-06 and a further £80 million per annum from 2007-08 towards meeting the fEC of research. The intention is to move to paying close to 100% of the full economic costs of projects by the beginning of the next decade, taking account of capital funding streams.

**SRIF**

- 10 SRIF 2 provided over £1 billion of investment in science and research infrastructure during 2004-05 and 2005-06. SRIF 3 allocated a further £500 million a year in 2006-07 and 2007-08. The priority for SRIF2 and 3 funds was, for most institutions, to address past underinvestment and not about increasing capacity.

***Research capital investment fund***

- 11 In October 2007 the UK Science Budget was announced as part of the 2007 Comprehensive Spending Review. A key allocation from that budget is a new research capital investment fund (RCIF) being created for institutions carrying out Research Council funded projects. This permanent funding stream replaces the temporary SRIF programme.
- 12 By moving to a new, permanent, more predictable funding stream, the aim is to help institutions maintain their research infrastructure and avoid the major backlog problem re-occurring; allowing

institutions to maintain their research infrastructure at a sustainable level into the future.

- 13 The Department for Innovation, Universities and Skills (DIUS) has indicated that, UK-wide, approximately £650 million will be available over the next three year spending review period (2008-09 to 2010-11). This funding will be allocated to each institution on the basis of its Research Council income over a three year period. The £650 million includes some additional transitional funding to help institutions in the transition from SRIF to RCIF.

### ***Capital funding***

- 14 For 2008 to 2011 English institutions have been allocated £1,086 million for learning and teaching capital and £1,276 million for research capital. For the period 2008-09 to 2010-11 the Scottish Funding Council has plans to allocate a minimum of £240 million to provide Scottish institutions with one capital funding stream for both learning & teaching and research infrastructure. A circular advising Scottish institutions of this is to be issued on 2 May 2008. For 2008-09 to 2010-11, institutions in Wales have been allocated £38 million for learning and teaching capital and £56.3 million for research capital although institutions can vire between the two streams.

### **Assessment criteria**

- 15 Each of the Funding Councils reviewed the strategic plans, trigger metrics and other performance information such as financial forecasts, estates strategies and existing financial/risk assessments to assess whether institutions appeared to be on a sustainable trajectory.

### **Key findings**

#### ***Money***

- 16 Operating results show a slightly improving picture in 2006-07 with the number of institutions reporting surpluses increasing from 115 in 2005-06 to 119 in 2006-07.
- 17 Liquidity ratios continue to be healthy with the sector average cash balances of 70 to 80 days of expenditure cover.

### *People*

- 18 The 'people' capacity and productivity metrics remain positive in 2006-07 with total income and research income per FTE continuing to grow at constant prices. Total externally sponsored research income also increased in 2006-07. The percentage of staff aged over 55 remains broadly static over the period.

### *Buildings*

- 19 The level of capital expenditure was lower in 2006-07 although the condition of buildings continues to show improvement for the UK as a whole. The TRAC adjusted operating results again emphasise the need for increased investment, however the results show an improvement in 2006-07 with the average deficit as a percentage of income 6.3% (2005-06: 6.7%).

### *Equipment*

- 20 Expenditure on equipment continues to be maintained in real terms by the sector as a whole.
- 21 Detailed results from the trigger metrics are provided at **Annex C**.

### *Key issues from the analysis*

- 22 In some instances it was difficult to determine whether institutions had embedded long term Frameworks within their strategic planning processes. However, the Funding Councils' review of strategic plans and financial forecasts showed that in general institutions have addressed sustainability across all of their activities.
- 23 At sector level operating surpluses are forecast over the Funding Councils' respective planning periods. Increased funding from the Research Councils and the introduction of variable fees in England, Wales and Northern Island have contributed to this position. However there are potential risks facing the sector. These include:
- future pay increases and increased pension contributions; and
  - increased competition which may see income growth more difficult to maintain.
- 24 An increase in long-term borrowings is forecast to part fund programmes of capital expenditure. This has resulted in an increase in payments to service these borrowings and could put pressure on

institutions who fail to achieve their income projections and do not constrain costs.

- 25 The forecasts were prepared prior to the announcement of the Government's expenditure plans for 2008-09 to 2010-11. Institutions are now revising their budgets and medium term forecasts.
- 26 The challenge for institutions is to maintain financial and institutional sustainability. The actual level of surplus required to do this will of course depend on the circumstances of individual institutions.

### RCUK review

- 27 The RCUK has recently announced a review of the implementation of full economic costs for funding higher education institutions research. The purpose of the review is to ensure that the change to full economic costs has put higher education institutions on track for delivering long term sustainability in research. The review will report to RCUK by the end of 2008.

### Sustainability and the potential risk to the research base

- 28 Table 1 shows the value of the level of externally sponsored research, the main QR grant awarded and the total of the two in 2006-07. It then relates this to the volume of research income consumed by those institutions over which we have some concerns, broken down into the QA benchmarking groups. This provides a rough measure of risk expressed in terms of the investment in research.

**Table 1 - Research funding and institutions of concern**

	Total UK sector value	Total value of HEIs of some concern	Value at HEIs of some concern		
			Groups A & B	Groups C & D	Groups E, F & G
	£000	%	%	%	%
Externally sponsored research	3,369,156	1.7%	1.4%	0.4%	0.0%
Main QR Grant	1,664,701	1.5%	1.2%	0.4%	0.0%
Total	5,033,857	1.7%	1.3%	0.4%	0.0%

- 29 The table highlights that only a small proportion (1.7%) of research is undertaken at institutions over which there are some concerns about their long-term sustainability, this has increased from 0.7% in 2004-

05. This increase is due to a change in the institutions of some concern which fall into Groups A and B, in 2006-07 the institutions in this grouping are larger in terms of research income received than in previous years. The funding councils will continue to maintain close dialogue with those institutions where there are some concerns.

### **Next steps**

- Subject to Funders' Forum comments to report the main findings to HM Treasury.
- Complete the trigger metrics data gathering exercise for 2007-08.
- Discuss whether the Group would wish an update produced in 2009 and a substantive report in 2010.

### **Recommendation**

- 30 Members of the Funders' Forum are invited to consider and comment on the contents of this report.

### **Further information**

- 31 For further information please contact either Wilma MacDonald, Financial Analyst, telephone 0131 313 6565/email [wmacdonald@sfc.ac.uk](mailto:wmacdonald@sfc.ac.uk) or Julie Munro, Financial Analyst, telephone 0131 313 6511 / email [jmunro@sfc.ac.uk](mailto:jmunro@sfc.ac.uk)

## Annex A

### Background

- 1 The monitoring arrangements were developed by the financial sustainability sub-group, chaired by Roger McClure, and endorsed by the Funders' Forum and HM Treasury in spring 2005. Looked at together, these provide an indication of the sustainability of an institution's 'adaptive capacity'.

### Framework

- 2 Institutions were asked to prepare a framework which set out how long-term sustainability was to be achieved. Broad guidance was provided and institutions encouraged to prepare their frameworks in the context of existing strategic planning processes and to focus on sustaining adaptive capacity, rather than preserving current activities. Adaptive capacity should reflect how an institution manages its key resources – money, people, equipment and buildings – and should respond effectively to changing demands over the next ten years or so.
- 3 We recognised that the deadline set for institutions to prepare their frameworks was demanding and that it would mean these being prepared outwith the normal planning cycle for most institutions. For these reasons we informed institutions that we would consider these initial frameworks to be indicative and that in future we would expect them to become embedded and updated as part of their next strategic planning exercise.

### Trigger metrics

- 4 The trigger metrics provide a standard set of data which, when set alongside an institution's framework, offer a high level view of an institution's direction of travel. As with the framework, the metrics cover the key resources of money, people, equipment and buildings. A list of the metrics is provided at **Annex B**. Mindful of minimising the burden on institutions, all of the metrics data are drawn from sources already available to the funding councils.
- 5 Most of an institution's resources, in particular people and buildings, change and can be changed only over long timescales, emphasising the need to look at trends and direction of travel rather than absolute values. For that reason, data on the metrics was produced initially for

a three year period (2001-02 to 2003-04) with the intention that it would be updated annually.

### **Relationship between frameworks and trigger metrics**

- 6 Institutions were asked to try and link their frameworks (forward projections) and their trigger metrics (historic data). However, given the different time horizons this proved difficult for most institutions. While the trigger metrics provide quantified evidence of trends (albeit only three or four years) this naturally lags behind future plans. However, we would expect, particularly as the time series becomes longer, future frameworks to reflect institutions' responses to the trigger metrics.

### **Analysis and presentation of data**

- 7 In order to improve the quality of the analysis and presentation of the trigger metrics data, institutions were grouped based on their volume of research activity. Institutions were divided into six groups (A to F). These are the same groupings as devised by the Quality Assurance (QA) team which undertook the TRAC benchmarking exercises as part of the process of moving to full economic costs for research projects. This exercise grouped institutions based on their level of funding council and research council income in 2002-03, with groups A and B being the most research intensive. At this time, groups A and B institutions accounted for just under 90% of the total research income going into the sector. Also, 78% of institutions who attained a 5\* rating in the 2001 RAE exercise are in groups A and B, making the groupings a broad proxy for RAE ratings.

### **Grade 4 suitability**

- 8 Grade 4 suitability is defined as failing to “support current functions and/or are unsuitable for current use. The operational problems associated with such space are major, and are constraining current functions in the space”.

## Annex B

	<b>Trigger Metrics</b>	
1	Operating surplus/(deficit) adjusted by fEC net adjustment from TRAC data	£'000
2	Operating surplus/(deficit)	£'000
3	Gearing ratio – total long-term borrowings/total general funds	%
4	Liquidity ratio - days ratio of cash (plus short-term investments) to expenditure (less depreciation)	Days
5	Total income per academic FTE	£/FTE
6	Total research income per academic FTE	£/FTE
7	Percentage of permanent academic staff aged 55 or over	%
8a	Total value of externally sponsored research	£'000
8b	Externally sponsored research as a % of total income	%
9a	Total capitalised expenditure on equipment	£'000
9b	Capitalised expenditure on equipment as a % of the balance sheet value of equipment	%
10	Total expenditure on major and minor works (capital)	£'000
11	Total expenditure on repairs and maintenance (recurrent)	£'000
12a	Proportion of building condition (% GIA) in condition C and D	%
12b	Cost to upgrade buildings in condition C & D to condition B <sup>1</sup>	£'000
13	Proportion of buildings space (GIA) with poor functional suitability (Grade 4) <sup>2</sup>	%
14a	Total GIA	Sq metres
14b	Total income per square metre	£/Sq Mtr

<sup>1</sup> Building condition B is defined as "sound, operationally safe and exhibiting only minor deterioration"

<sup>2</sup> Grade 4 building is defined as one that "fails to support current functions and/or are unsuitable for current use. The operational problems associated with such space are major, and are constraining current functions in the space"

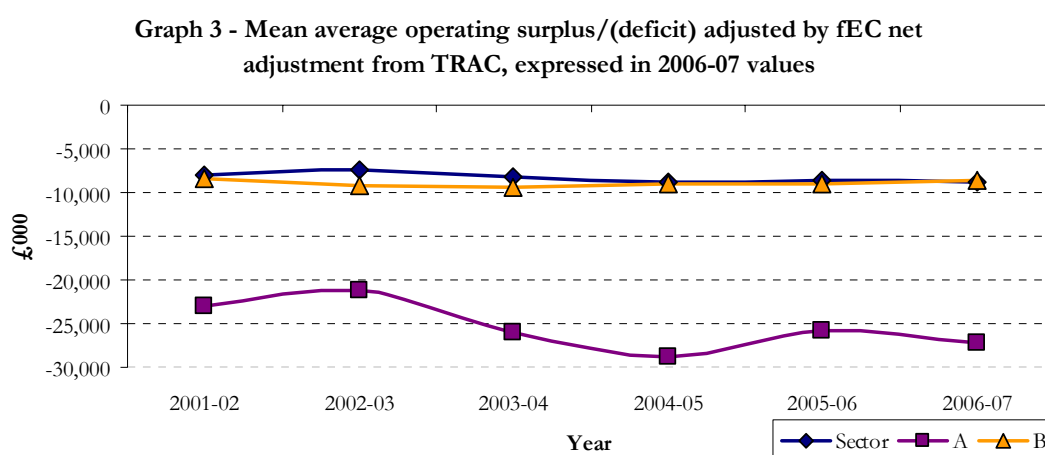
## Findings from analysis of trigger metrics

- 9 The data covers the period 2001-02 to 2005-06 and 2006-07 where available. Again, results have been expressed in constant values, where appropriate, using 2006-07 as the base year to show the 'real' trends over time.
- 10 The trigger metrics cover money, people, equipment and buildings and the analysis follows this structure.

## Money and people

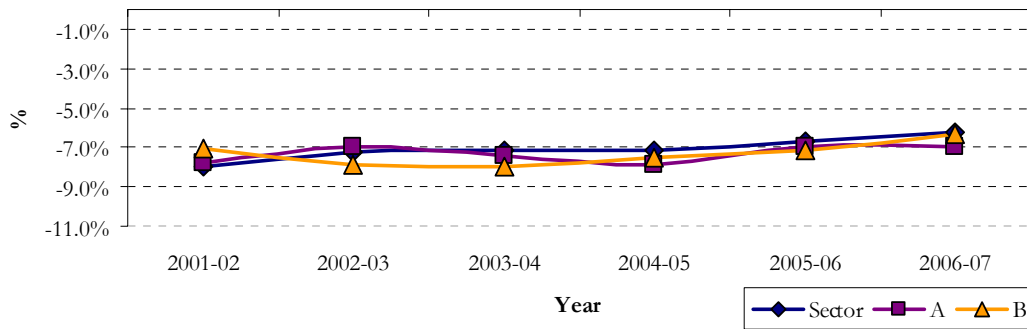
### *Metric 1: operating surplus/(deficit) adjusted by fEC net adjustment from TRAC data*

- 11 This metric continues to show a negative trajectory at sector and group A and B levels. This metric shows a slight improvement for 2006-07 at group B level. The number of institutions reporting a TRAC adjusted surplus in 2006-07 was eleven which was in line with the previous year's figure.



- 12 When viewed as a percentage of income the results for 2006-07 continue to show some improvement at sector and group B levels. At group A level the results remain stable.

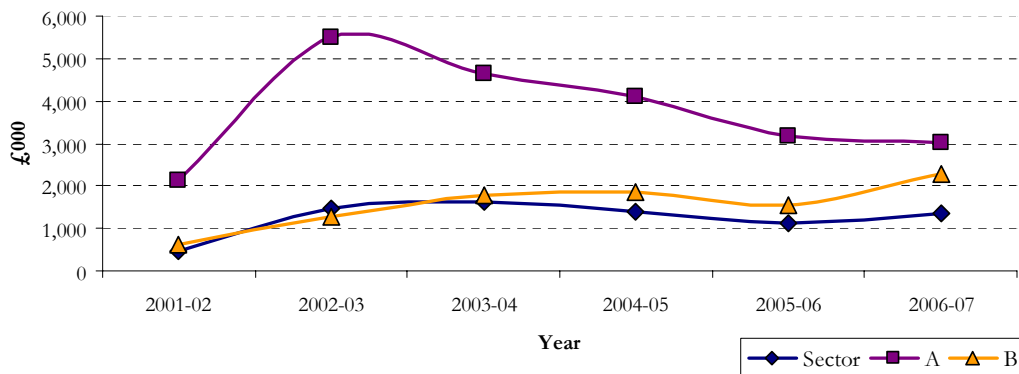
**Graph 4 - Mean average operating surplus/(deficit) adjusted by fEC net adjustment from TRAC as a percentage of income**



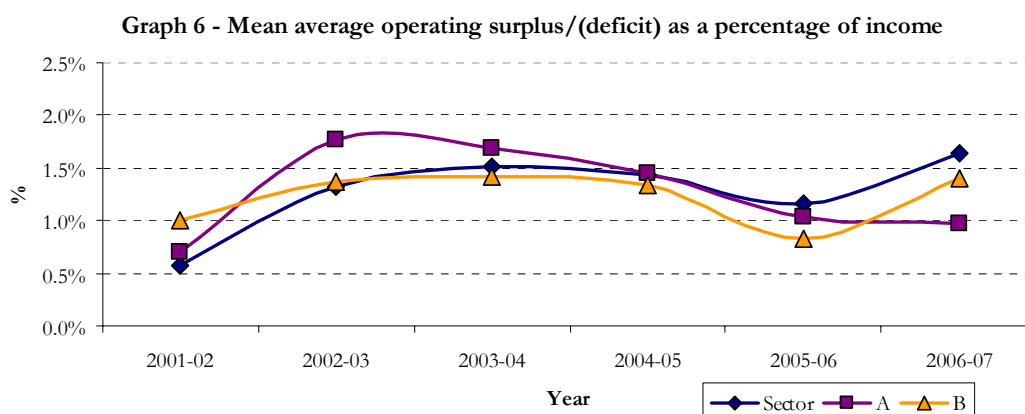
**Metric 2: operating surplus/(deficit)**

13 Graph 5 shows an improving picture for 2006-07 at the sector and group B levels. Although there is a slight deterioration for group A, the average surplus for this group is still above £3 million. This again may be partly due to institutions investing in the 2008 RAE exercise and the impact of implementing the HE Framework Agreement and sector pay settlement. The number of institutions in surplus increased to 119 in 2006-07 (115 in 2005-06).

**Graph 5 - Mean average operating surplus/(deficit) expressed in 2006-07 values**



14 As graph 5 highlighted, the larger institutions have the scale to generate larger surpluses. However, we have again standardised this metric by expressing the operating position as a percentage of income (graph 6). In 2006-07 the results again broadly mirror those shown in graph 5.



### ***Metric 3: gearing***

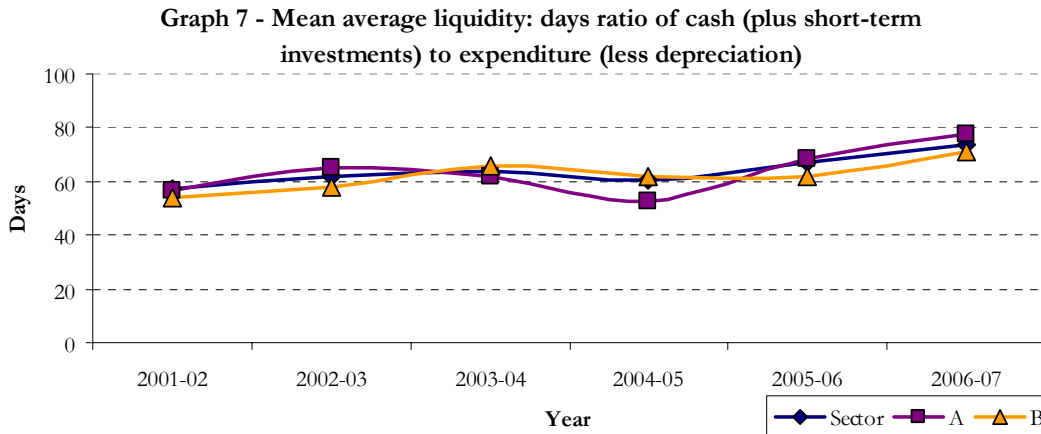
**Table 1 - Gearing Ratios**

Gearing	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07
Sector	0.5	0.5	0.5	0.5	0.6	0.5
A	0.3	0.3	0.3	0.3	0.4	0.4
B	0.6	0.7	0.7	0.7	0.8	0.7

- 15 Table 2 again shows a decrease in the gearing ratio at sector and group B levels. Group A continues to have the lowest average gearing ratio. Group B institutions remain the most highly geared which is mirrored by proportionately higher levels of capital spend (see graph 16).

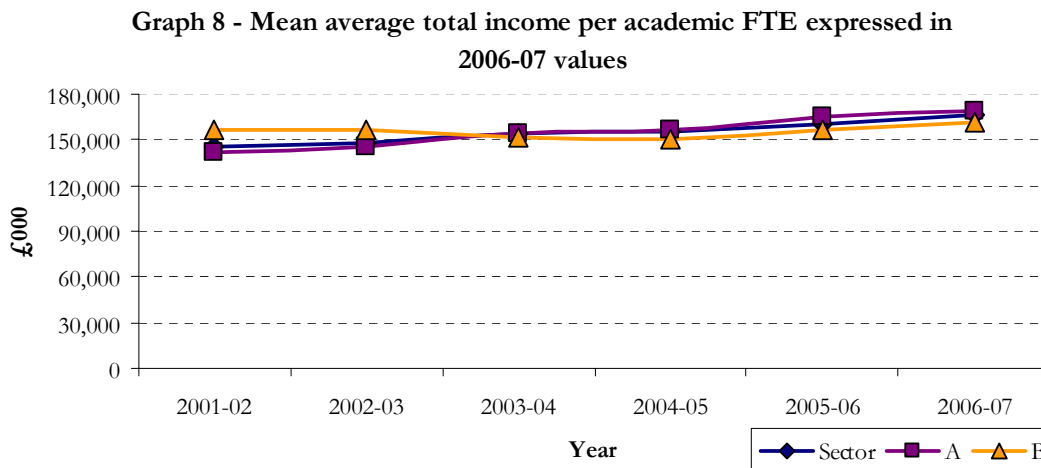
### ***Metric 4: liquidity***

- 16 Liquidity shows a further improvement at sector and group A and group B levels in 2006-07. As shown in graph 7, the UK average is that institutions have enough cash to cover between 70 and 80 days expenditure.



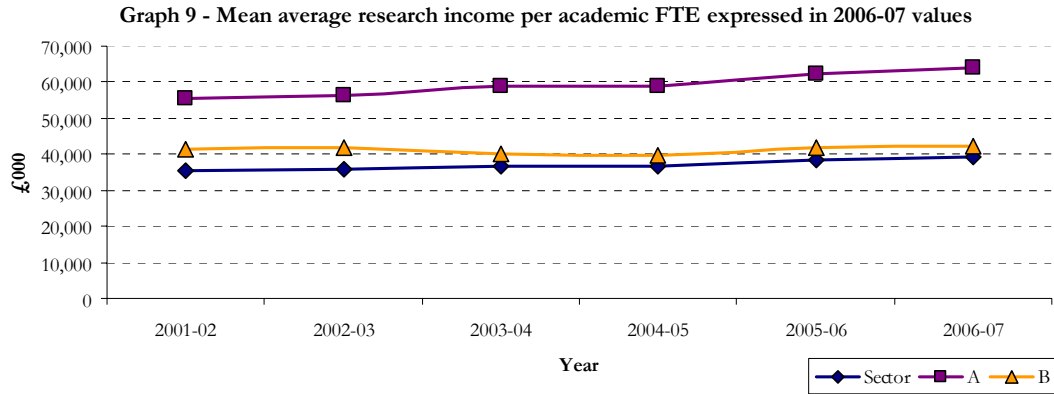
**Metric 5: total income per academic FTE**

17 Graph 8 shows that for 2006-07 at sector and groups A and B levels, income per FTE is still showing a gradual increase at constant prices.



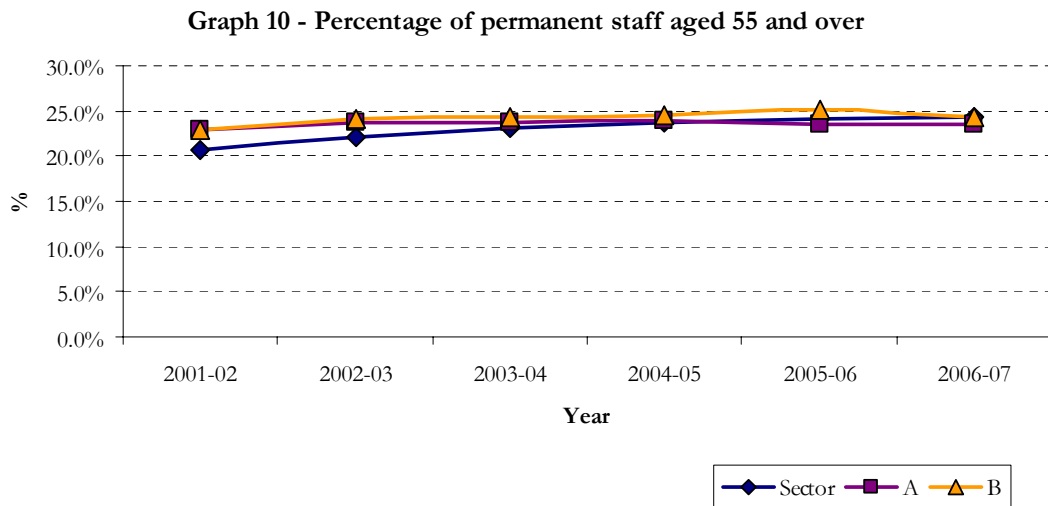
**Metric 6: total research income per FTE**

18 For 2006-07 research income per FTE continues to rise with group A institutions' figures significantly above the sector and group B averages (graph 9). When contrasted with total income per FTE (graph 8) the group A results are again only slightly above the sector and group B average. Externally sponsored research income as a percentage of total income (graph 12) shows a slight improvement in 2006-07 for group A institutions. At group B level the figures show a deterioration in 2006-07 but the trend remains stable at sector level.



**Metric 7: percentage of staff aged 55 or over**

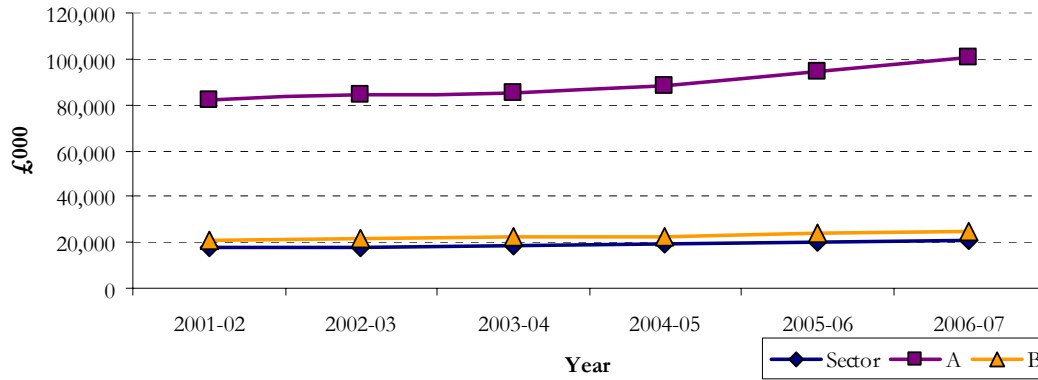
19 At UK sector level the average is highest and shows an increasing trend (graph 10). At group A level the average remains broadly static over the period.



**Metric 8a: total value of externally sponsored research**

20 Externally sponsored research continues to show steady increases with group A institutions accounting for over 70% of the total in 2006-07 (graph 11).

**Graph 11 - Mean average externally sponsored research expressed in 2006-07 values**



***Metric 8b: total externally sponsored research income as a percentage of total income***

21 In 2006-07, graph 12 indicates that the proportion of research to total income has risen slightly for group A institutions (25.7% to 25.8%). However the average for group B institutions has fallen slightly in 2006-07. The average remains stable for the sector in 2006-07.

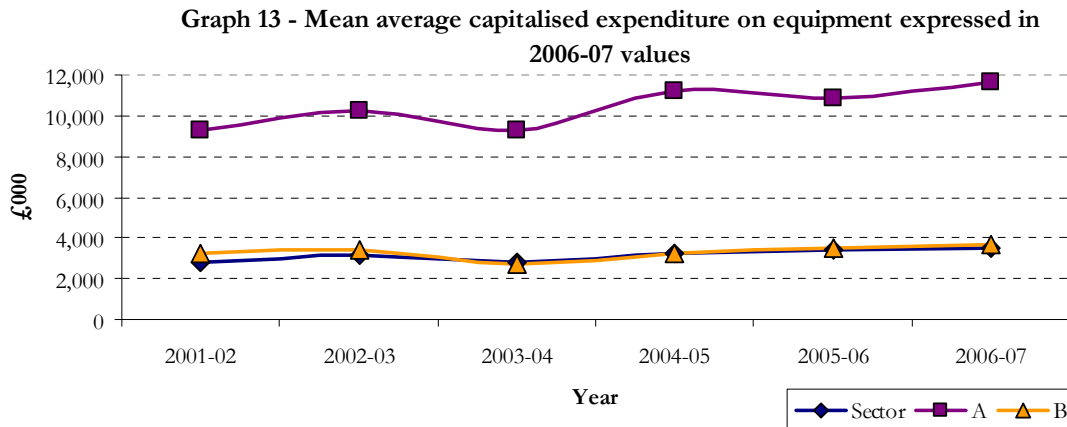
**Graph 12 - Mean average externally sponsored research as a percentage of total income**



**Equipment and buildings**

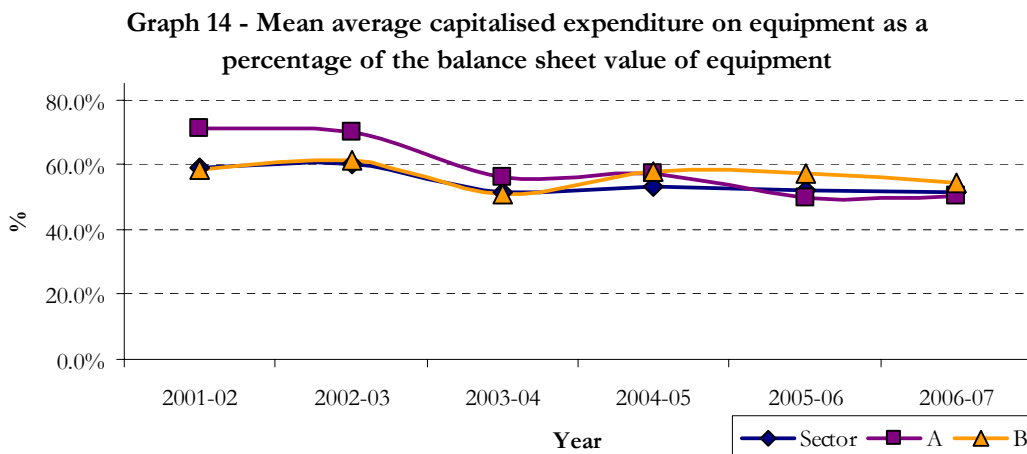
***Metric 9a: total capitalised expenditure on equipment***

22 The fairly steady trend for the sector and group B continues in 2006-07. The average for group A institutions shows an increase in 2006-07 (graph 13).



***Metric 9b: total capitalised expenditure on equipment as a percentage of the balance sheet value of equipment***

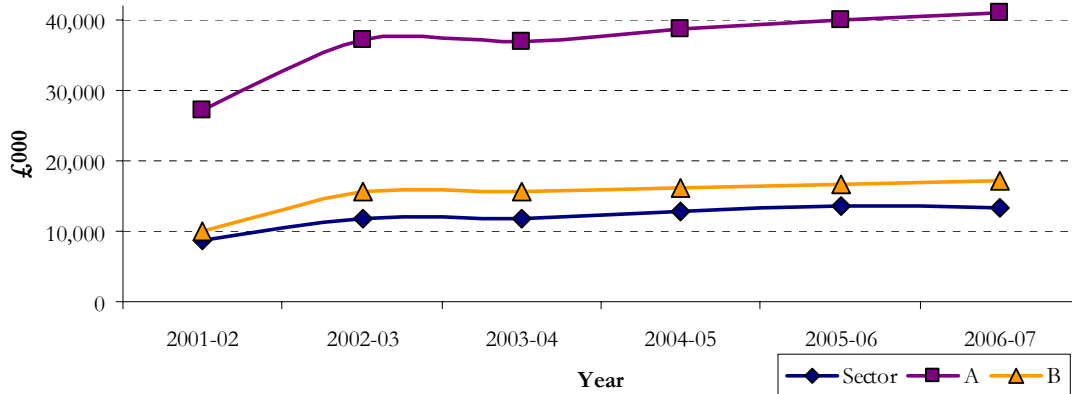
23 As a percentage of the written down balance sheet value of equipment, the average at UK sector and group B levels has fallen but remains above 50% in 2006-07. However the percentage has increased slightly to 50% for group A institutions (graph 14). Overall the declining trend continues.



***Metric 10: total expenditure on major and minor works (capital)***

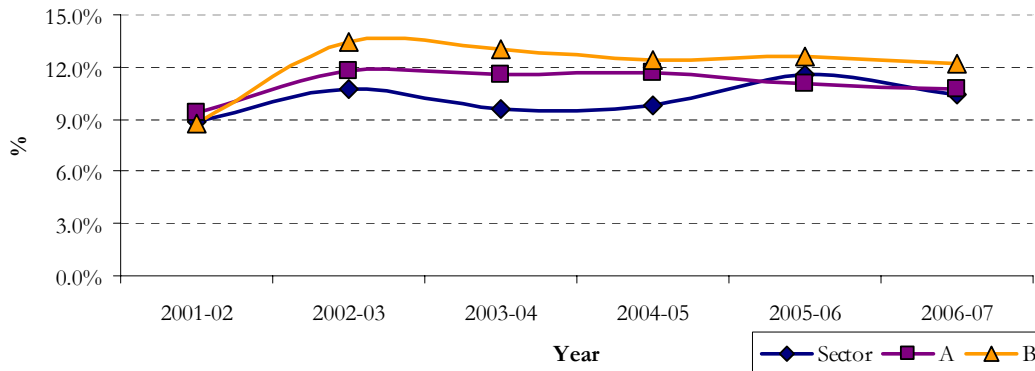
24 Graph 15 shows that expenditure in 2006-07 increased at group A and group B levels reflecting significant investment by these institutions in terms of capital expenditure on their estates. However the UK average has fallen slightly in 2006-07.

**Graph 15 - Mean average expenditure on major & minor works (capital) expressed in 2006-07 values**



25 Again to give context, this metric was calculated as a percentage of total income (graph 16). In 2006-07 group B continued to have the greatest expenditure as a percentage of total income. Although the spend increased at group A and group B levels, spend in proportion to income decreased in 2006-07 as well as at UK sector level.

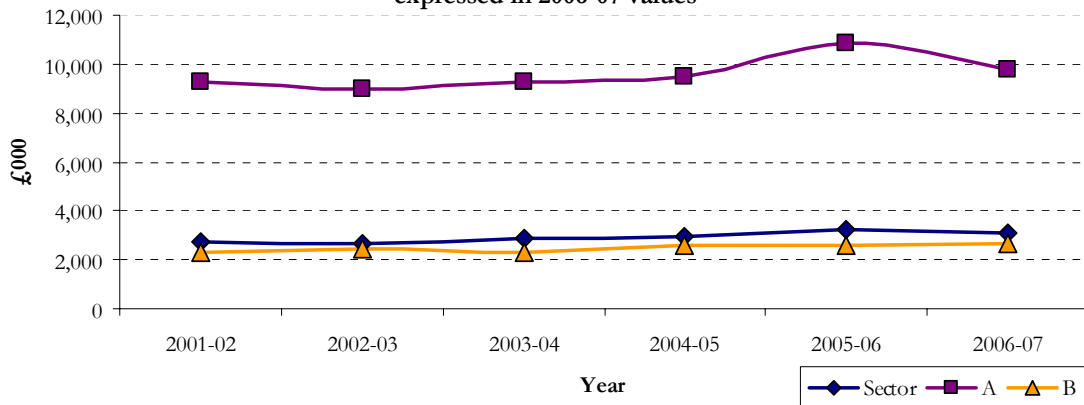
**Graph 16 - Mean average expenditure on major & minor works as a percentage of income**



***Metric 11: total expenditure on repairs and maintenance (recurrent)***

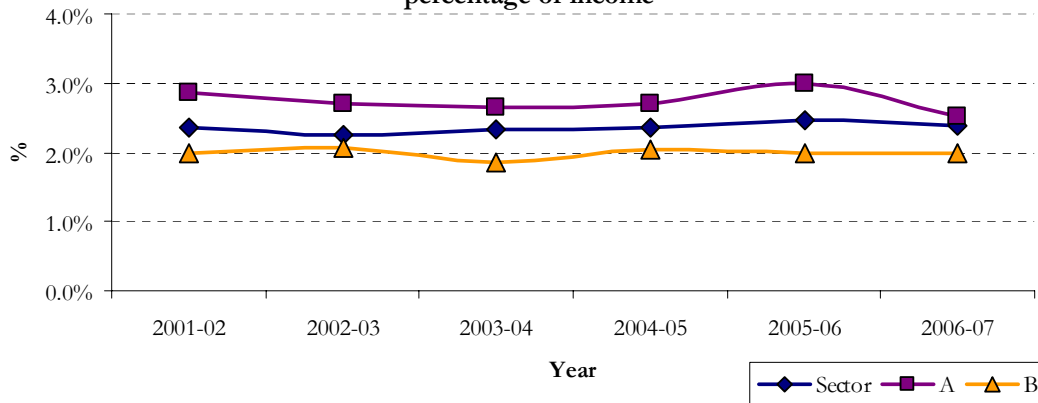
26 Graph 17 shows that the average level of investment decreased in 2006-07 for the sector and group A institutions but remains stable for group B institutions. Group A accounted for 47% of the total expenditure

**Graph 17 - Mean average expenditure on repairs & maintenance (recurrent)  
expressed in 2006-07 values**



27 When looked at as a percentage of total income (graph 18), the picture is again mirrored.

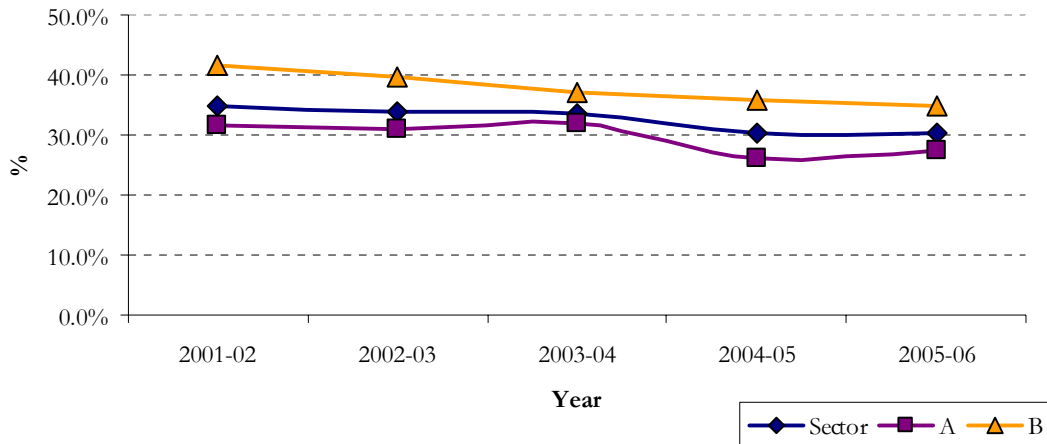
**Graph 18 - Mean average expenditure on repairs & maintenance as a  
percentage of income**



***Metrics 12a: proportion of building (GIA%) in condition C & D***

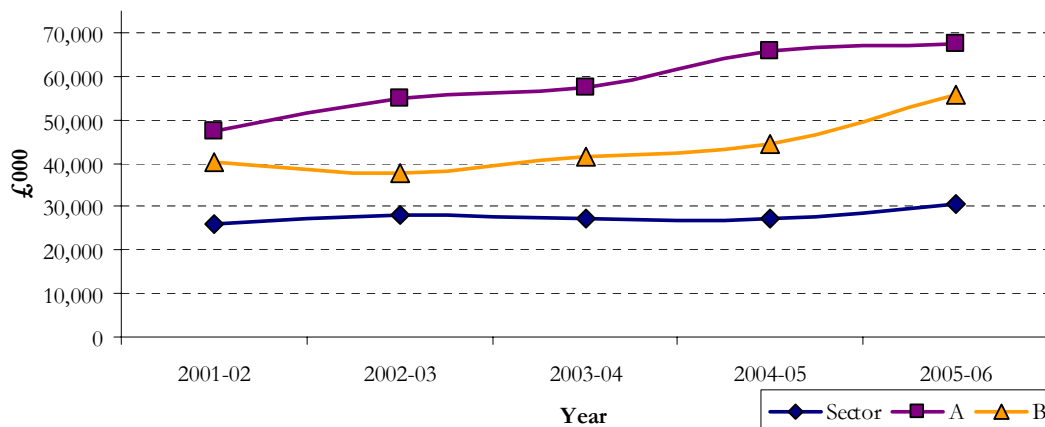
28 Graph 19 indicates that in 2005-06 the sector and group B continue to show a declining trend. However group A shows an increase in 2006-07. The associated costs show an increasing trend (graph 20). The proportion of institutions' estates classed as 'poor functional sustainability' (grade 4) (see graph 23) continues to be significantly less and still shows an improving (declining) trend.

**Graph 19 - Mean average proportion of buildings in condition C & D**

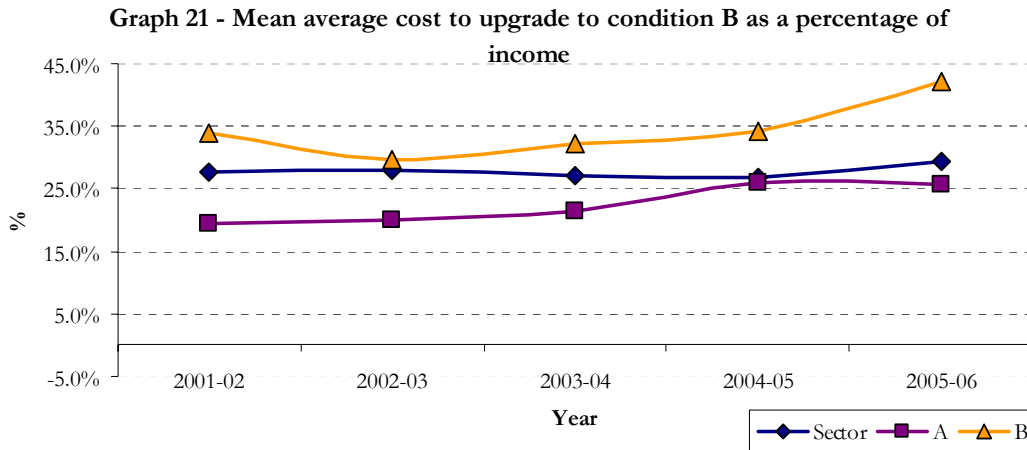


**Metric 12b: cost to upgrade buildings in condition C and D to condition B**

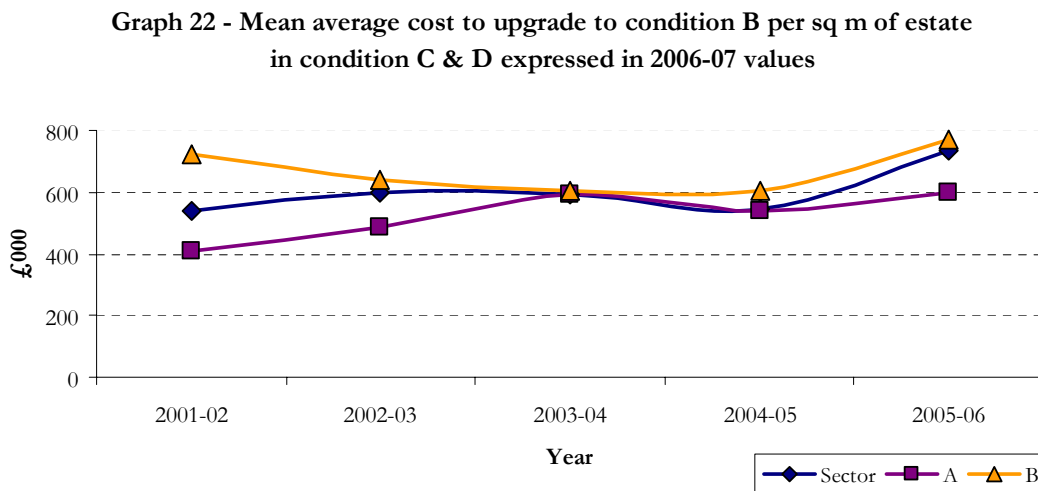
**Graph 20 - Mean average cost to upgrade buildings in condition C & D to condition B expressed in 2006-07 values**



- 29 Although graph 19 shows that the proportion of buildings in C and D has reduced for the sector and group B, the financial burden to upgrade to condition B continues to increase in 2005-06 particularly for group B (graph 20).
- 30 Cost to upgrade to condition C and D was again analysed as a percentage of total income (graph 21). Group B continues to have the highest average cost to upgrade as a percentage of income and shows a significant increase in 2005-06 (34.3% to 42.2%). Group A institutions show a slight decrease in 2006-07 (26% to 25.7%).



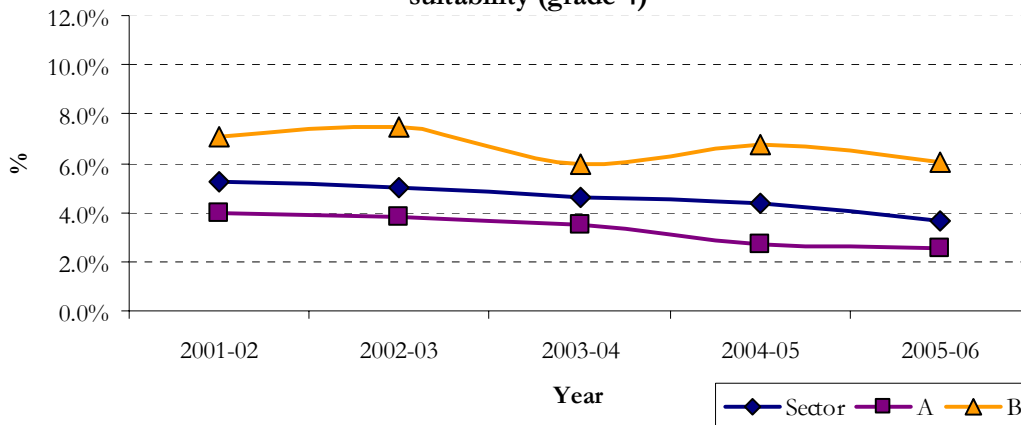
- 31 Graph 22 looks at the cost to upgrade to condition B on a cost per square metre, based on the GIA in condition C and D. The average cost shows an increase at sector and group A and B levels in 2005-06.



***Metric 13: proportion of building space (GIA) with poor functional suitability (grade 4)***

- 32 The definition of grade 4 suitability is provided in annex A. It is encouraging that the proportion in grade 4 continues to be well below the proportion in condition C and D (see graph 19) and the trend continues to be a positive one (graph 23).

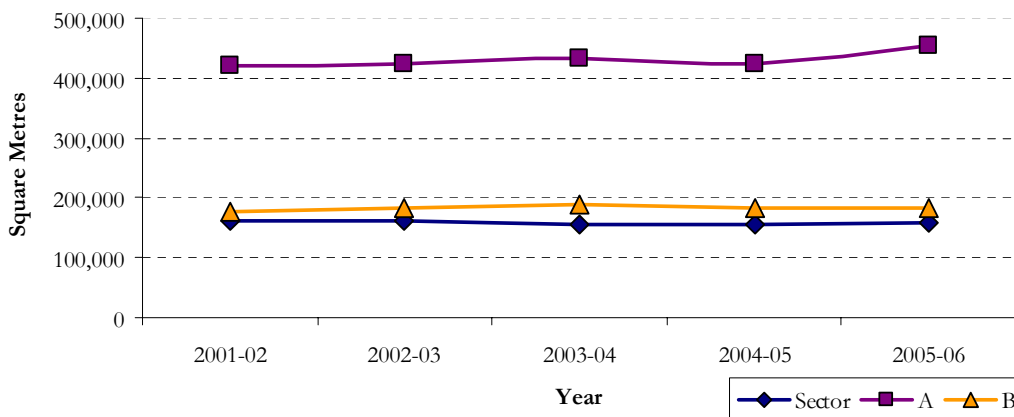
**Graph 23 - Mean average proportion of buildings with poor functional suitability (grade 4)**



***Metric 14a: total GIA***

33 The sector shows a very gradual increase in the size of its estate. Group A shows a larger increase, however group B shows a slight decrease.

**Graph 24 - Mean average total GIA**



***Metric 14b: total income per square metre***

34 Graph 25 continues to show a positive trend each year.

Graph 25 - Mean average total income per square metre expressed in 2006-07 values

