Universities UK

Funding local development

13 March 2017

Introduction

This factsheet[1] provides a high-level overview of finance relevant to universities funding local growth, regeneration and capital projects. This includes locally-derived funding streams such as business rates, and also national or international sources such as bonds and loans. It does not cover national streams such as the Higher Education Innovation Fund or the UK Research Partnership Investment Fund, or conventional funding for research and teaching.

Universities should be aware of different funding opportunities for several reasons. Income from central government and tuition fees is unlikely to grow significantly in the near future due to fiscal constraints and an anticipated slowdown in international student recruitment following the outcome of the EU referendum. Secondly, increased university engagement with local communities and businesses is leading to new opportunities for collaboration and the need for alternative and more diverse sources of funding. Historically low interest rates are encouraging large-scale borrowing, and competition between universities is leading to demand for new facilities, amenities and student housing. Perhaps most importantly, government policy on devolution and the move towards greater fiscal decentralisation is increasing the responsibility and decision-making of local councils and combined authorities, and the need for universities to be working with these bodies.

Trends in local finance

Several trends are shaping the form and delivery of local funding:

- There is a shift from grants to loans, evidenced by the changing delivery model of bodies such as Innovate UK. The aim is that more good projects can be funded, with a resulting expectation that successful projects should repay (although, in some cases, unsuccessful ones may not need to – encouraging a healthy degree of risk).
- Using funds to leverage other finance. For example, Combined Authority Investment Funds might match Local Growth Fund projects, or finance large loans; anticipated business rate receipts might service bonds. This requires an understanding of how projects fit together.
- We are likely to see a closer alignment of private and public sector funding sources, largely due to closer working between the two as a result of more decisions being taken at the local level through city and devolution deals.
- For some funds, local partners are required to work closely together (see box: 'Working in a One Local Estate manner'). Even for funds where collaboration is not necessarily required – such as bonds or loans – a stronger case for funding can be made through working with local stakeholders.
- An emerging emphasis on strategic programmes rather than stand-alone projects, and accordingly an emphasis on long-term planning rather than short-term outputs.

These trends may require changes to how universities engage with alternative funding. These guiding principles reflect the lessons learned by universities:

- The success of programmes may depend on deep local coordination to avoid duplication, to ensure sustainability and maintain community support. Smart specialisation, a methodology underpinning European Regional Development Funds, requires work to be 'embedded' in the locality, an ex-ante conditionality of the funding.
- The need to get key people on side very early, for example university boards and those working in university finance offices (and HEFCE in the case of large borrowing), and to understand appetites for risk. Case studies of institutions developing large programmes with 'new' forms of funding often stress the benefits of having

key internal allies at an early stage. Many also note that documentation always takes longer to prepare than expected.

- The need to employ professional technical expertise, especially as many of the new forms of funding do not operate in the same way as conventional funding. This is in addition to the specialist legal support required to access bonds and large loans, for example.
- Successful programmes effectively communicate the strategic rationale for the programme itself, for the amount of funding, and the source of funding. They conduct detailed scenario and risk planning.

What are the risks?

Funding is increasingly risk-based and long-term, meaning large scale spending will effectively correlate to the degree of confidence in the growth of individual institutions. Several factors will test this confidence:

- Growing competition between institutions, with the government expecting some to 'exit the system' and encouraging new alternative private providers.
- The downgrading of university credit ratings following Brexit (with the exception of the University of Cambridge).
- The effects of Brexit, especially on EU staff and students and access to funding (see 'what are the implications of Brexit?')
- Immigration policy and attractiveness of the UK for international students and staff.
- A demographic decline in the number of 18-year-olds and thus a decrease in future tuition fee income.

Although universities are likely to be able to continue accessing alternative funding streams successfully, they may face other challenges in light of these factors: for example, university boards may be reluctant to sign-off on large infrastructure projects. The principles of effective university engagement with local finance outlined above are therefore especially important. In particular, there should be coordination between local universities with each other and with local partners as part of a joint strategy for their locality that may also cover business support, community engagement and infrastructure development.

What are the key forms of alternative funding?

Alternative funding can be broadly split into two categories: wider funding sources that universities can choose to access (such as bonds and loans), or devolved funds that are location-specific. The latter includes grant funding to regions (Single Pot and investment funds), loan funding to regions or local authorities, local taxation power, and funding via the Local Growth Fund and European Structural and Investment Funds.

Bonds

The UK higher education sector raised over £1 billion through bonds in the past year; Cardiff University alone raised £300 million with a record low borrowing cost for universities of 3%. The minimum bond amount tends to be £250 million, although smaller amounts (£10 million+) are possible through private placement – a fewer number of investors and a shorter maturity (10–25 years rather than 30 years+).

Example: social impact bonds

Social impact bonds are designed to help reform public service delivery and are very different to capital markets bonds issued by universities to fund capital expenditure. Projects may address issues such as aging or management of diabetes. Funding is conditional on achieving results – investors pay for the project at the start, and then receive payments based on the results achieved by the project. Challenges tackled by the project are often complex and require close working between multiple partners, but are also dependent on ongoing evidence and data collection and are often closely linked to university research projects.

Loans

Loans are becoming more commonplace: with fiscal constraints they share risk whilst widening the pool of projects funded. Innovate UK lists evolving funding models as one of the five points of its strategic plan, likely to include more loan-based products. And in particular for businesses, the nature of loans themselves are evolving to include peer-to-peer lending, equity-based crowdfunding, reward-based crowdfunding and invoice trading. 'Traditional' bank loans may be more suited to certain projects – for example where all the money is not required up front – and they may also be materially cheaper.

Example: European Investment Bank (EIB)

The EIB is the European Union's bank and the largest lender by volume globally. In April 2016, University College London received £280 million to expand its campus, the largest sum loaned to a university to date. 21 UK universities have directly accessed funding, with most accessing £40–£90 million. Of all EIB investment to universities across the EU, UK institutions have received almost a quarter – over £2.4 billion.

The minimum loan amount is usually €25m, although smaller projects can be pooled, and up to 50% of project costs can be financed by the EIB loan.

Devolution- and city-deal specific funds

These are typically investment funds negotiated as part of agreements between local authorities and central government. Furthermore, the 2016 Autumn Statement saw an announcement that mayoral combined authorities will have powers to borrow for their new functions, subject to agreeing a borrowing cap with HM Treasury.

There are also cross-LEP funds, in the case of the Northern Powerhouse Investment Fund (which doesn't cover the North East) and the Midlands Engine Investment Fund, offering £400 million and £250 million respectively to help small businesses grow. These funds were confirmed in the 2016 Autumn Statement, although longer-term complications may arise as they are backed by the European Regional Development Fund (ERDF) and the EIB (see 'What are the implications of Brexit?').

Example: Long-Term Investment Funds

Announced as part of devolution deals, these provide £15m-£30m per year over up to 30 years, split between capital and revenue, and are subject to five-yearly assessments of the economic benefits of funded projects. They may act as security for larger (£1 billion plus) loans or as match for other funds, or be consolidated with other funds (such as consolidated transport grants, Local Growth Fund and localised business rates) as a larger 'Single Pot'.

For a summary of areas with devolution deals, see Universities UK's factsheet on elected mayors (November 2016)

Devolved funding pots

Defined 'pots' of money that are passed from or negotiated between central government departments and Local Enterprise Partnership (LEP) areas, or to city deal or devolution deal areas. The two key LEP funds – European Structural and Investment Funds (ESIF) and the Local Growth Fund – require match funding. Universities have historically been a significant source of match funding.

Example: Local Growth Fund (LGF)

The LGF can fund transport, physical infrastructure, public realm, business development, skills and training infrastructure, and innovation. The 2016 Autumn Statement announced £1.8 billion of funding for LEPs from the Local Growth Fund through a third round of Growth Deals. £556 million of this will go to LEPs in the North of England, £392 million to the Midlands, £151 million to the East of England, £492 million to London and the South East, and £191 million to the South West. Universities have financed projects through the Local Growth Fund and we encourage close working between universities and LEPs to develop future activity.

See also: Universities UK's factsheet on city deals (June 2016)

Localised fiscal policy

Covers a variety of local taxation mechanisms, such as the localisation of business rates (see below) and tax increment financing (allowing local authorities to borrow money for infrastructure projects against the anticipated increase in local business taxes resulting from that infrastructure, in designated areas and subject to limits), and enterprise zones (which include business rate discounts).

Example: Localisation of business rates

Against a significant drop in council revenue and spending since 2010, the government has announced a move towards a 100% Business Rate Retention Scheme (BRRS), starting with 50% from 2013–14. This allows local areas to keep the growth in business rates in their area as a result of new developments or refurbishments. The move towards 100% business rate retention provides strong incentives for revenue growth but also more risk. Universities should proactively talk to local councils about the implications of the BRRS on any future planned capital or regeneration projects.

For more detail on the implications of local retention of business rates, see: https://www.ifs.org.uk/publications/8705

For UUK's work on business rate revaluations for university estates, see: http://www.universitiesuk.ac.uk/policy-and-analysis/reports/Pages/rating-revaluation-2017-an-introduction.aspx

What are the implications of Brexit?

In October 2016 the government announced that funding will be guaranteed for European Structural and Investment Fund (ESIF) projects signed after the Autumn Statement and which continue after the UK has left the EU. As of November 2016, a total of 17% of the European Regional Development Funding (where universities are most engaged) pot of £2.8 billion has been committed, with universities particularly engaged with the innovation priority axis.[2]

There are also issues associated with UK university access to the European Investment Bank following the Brexit vote.[3] While there is no immediate change to the ability of UK institutions to access loans or the terms for these loans, the scope for universities to access these past the date at which the UK leaves the EU is uncertain, especially as EIB policy states that all lending has to promote the interests of the European Union.[4]

Conclusion

Funding mechanisms for local growth activity – including university infrastructure, business engagement and innovation programmes – increasingly require deep collaboration with local partners and strategic, long-term planning.

Universities should seek closer relations with their local councils. By doing so they can help to promote infrastructure improvement, encourage business growth and in turn make their locality more attractive to employers and develop local skills strategies that prepare students for the jobs of the future. Although there are inevitable risks with engaging with new forms of funding, universities have a strong track record of effective delivery and strong local impact.

Box 1: New Forms of Funding

Much of this material has been drawn from a series of workshops on New Forms of Funding, led by HEFCE and supported by Universities UK and the NHS Confederation. Slides for the three main workshops – 'Making a Success of Bonds', 'Integrated Finances for Strategic Infrastructures and Sites', and 'From Grants to Loans' – are available to download from the Local Growth Academy LinkedIn group, where information on future activity is also posted: https://www.linkedin.com/groups/8554561

Box 2: Working in a One Local Estate manner

The Local Government Association and Cabinet Office's One Public Estate programme supports 'collaborative property-led projects in local areas, delivering ambitious projects that transform local services', channelling practical support, expertise and central funding through local authorities. The integrated strategy-led approach to local working – bringing together the NHS, councils, universities and other local partners – provides a model for other similar projects. Case studies are online: http://www.local.gov.uk/onepublicestate/-/journal_content/56/10180/6706303/ARTICLE

See also: NHS sustainability and transformation plans (STPs), which are place-based, multi-year health and care plans that are built around the needs of local areas and their populations: http://www.nhsconfed.org/resources/2016/09/understanding-sustainability-and-transformation-plans

Notes

1. Jointly produced by Universities UK and the Higher Education Funding Council for England (HEFCE)
2. A list of approved contracted projects is available online: https://www.gov.uk/government/publications/european-structural-and-investment-funds-useful-resources
3. The House of Commons Library has published an excellent briefing paper on this and other EU funding sources and the implications of Brexit: http://researchbriefings.files.parliament.uk/documents/CBP-7847/CBP-7847.pdf
4. See: http://www.mills-reeve.com/shakeable-bonds-university-borrowing-after-brexit/

This is the seventh in a series of factsheets on innovation and growth. We welcome suggestions for other topics.

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