University of Cambridge

COUNCIL

Finance Committee

Minutes of the meeting held on Wednesday 11 July 2012.

Present: The Vice-Chancellor in the Chair, Dr Clark, Ms Coutu, Mr Downer, Mr Du Quesnay, Dr Foster, Professor Gilligan, Professor Hopper, Mr Johnston, Professor Lizieri, Mr Summers and Professor Young with the Registrary, the Director of Finance, the Director of Estate Management, the Head of the Registry’s Office and Dr Knapton.

Apologies: Mr Chote.

Mr Roger Taylor, Mr Kerry Sykes (from the North West Cambridge project); Mr Francis Burkitt and Ms Lucy Symondson (from Rothschild); and Mrs Cheffins (from the Legal Services Office) attended for the matters recorded as minutes 59 and 60. Dr Tony Raven, Dr Anne Dobrée attended for part of the discussion of the matter recorded as minute 61.

PART A: INTRODUCTORY

55. Procedure of the Committee – Declaration of Interest

Dr Clark, as an inventor with IP managed by Cambridge Enterprise, declared an interest in respect of the matter recorded as Minute 61 (Cambridge Enterprise). He also declared an interest in item 7 (FC(12)64) of straightforward and reported business; seal 2285 related to his work. Otherwise, no personal or prejudicial interests were declared.

56. Minutes

The Minutes of the meeting held on 9 May 2012 were approved.

57. Straightforward and reported business: agenda items starred as straightforward

A paper listing straightforward and reported business was received.

The Committee approved the matters for decision contained in the confirmed list of straightforward or reported business, and received the other material.
58. **Future business and work plan**

The following Papers were received and approved:-

- Paper FC(12)65 Updated statement for 2011-12
- Paper FC(12)66 Proposed workplan for 2012-13

**PART B: SUBSTANTIVE BUSINESS**

59. **North West Cambridge**

(i) **Progress report and financial summary**

The Committee received (as paper FC(12)67) a report on the current state of the North West Cambridge project and a financial summary.

Mr Johnston and the Director of the North West Cambridge Project reported. Paper FC(12)67 was an interim report; the numbers in the financial summary remained subject to review. The Syndicate for the West and North West Cambridge Estates would receive an updated financial summary and a draft Report on 17 September 2012. Subject to Syndicate approval, these materials would then be brought to the Finance Committee on 10 October 2012 with a view to providing a recommendation to the Council, at its meeting on 22 October 2012, that the NWC development should proceed. The Report would then be put to the Regent House for approval. It would be important to consider the extent of the financial information which could be provided in that Report without compromising the University’s commercial interests.

Detailed discussions with the planning authorities, including in respect of the S.106 agreement, were continuing. Good progress had been made and it was anticipated that the remaining issues would be resolved within a period of weeks and that the resolution to grant consent could be confirmed, as planned, at the Joint Development Committee of the Councils on 8 August 2012. Drafting of the S.106 legal agreement was already underway with view to completion in September in order to secure outline planning consent.

Phase 1 pre-development activities continued. The process of appointing architects for the University elements of Phase 1 had been completed and approved by the Syndicate. The recommendations would be reported to the Council at an informal special meeting on Monday 16 July 2012 after which the appointments would be publicly announced.

There were ongoing discussions with two college groups: one on an occupational lease basis for accommodation in a post-graduate student complex; the other for the purchase of land to provide family housing units.
The project programme remained as anticipated: if approval for Phase 1 of the project was granted, infrastructure work would start on site during the summer of 2013, with the first delivery of market housing in late 2014 and Key Worker Housing in July 2015.

Mr Sykes, Syndicate Finance Director, reported on the financial appraisal. The financial model was updated regularly and would be subject to further review in the course of the summer. The analysis was increasingly detailed and refined. The current financial appraisal demonstrated interest cover (at 5.25%) in 2035 of x1.4 for Phase 1 and x1.9 for the project as a whole. Peak borrowing requirements were £233m for Phase 1 and £368m for the whole site. Work on the sensitivities to the base case appraisal indicated that, even with significant variations, the project remained within viable parameters. There had been changes to a number of the figures as a result of the review and revision of the appraisal and the assumptions and details on which it was based. On expenditure, these particularly related to increased costs for the Key Worker Housing as a result of changes in unit mix and size; and the addition to the base case of University market housing and student accommodation. The financial model was based on a number of high level assumptions as follows: a return to economic growth; the demand for housing would continue to produce growth in capital value at a rate in excess of underlying inflationary trends; long term inflation would follow historic trends; the tax position would remain largely unaltered; and the University would be able to obtain credit on favourable terms. There were, in addition, a number of key assumptions which were specific to the financial appraisal. Inflation figures for the project as a whole were based on expert advice from external parties. Inflation assumptions for Phase 1 took account of current conditions and known construction costs.

The current authorised budget would be sufficient to take the project to the point of Regent House approval. However, in view of the tight delivery timescale and the costs benefits which would derive from meeting this, it would be desirable to initiate some preparatory works. It was therefore intended that a request to bring forward some limited expenditure would be brought to the Committee during the Michaelmas Term.

The following points were amongst those made in the course of discussion:

- Strategic and academic need were the main drivers for the project and the basis, ultimately, on which any decision to proceed would be made. In order to attract and retain the best staff and students from across the world, the University needed to be in a position to offer accommodation and academic and other facilities equivalent to those in competitor institutions. The project was therefore a vital strategic investment in the University’s long term academic future. There were potentially significant opportunity costs inherent in not pursuing the project; these were not included in the financial appraisal.
- However, it was vital to ensure (and to be able to reassure the University in the forthcoming Report) that the financing of the North West Cambridge project would not prejudice the core current academic
activities of the University. This would include the delivery of the ambitious capital plan either by means of internal resources or by external borrowing or by a combination of the two. The Report would therefore need to provide assurances that both interest cover and peak borrowing were within acceptable parameters.

− Once the decision to proceed with Phase 1 had been made, it should be assumed (barring exceptional circumstances or dramatically changed external factors) that further phases would follow and the entire site would be built out.
− It was agreed that further work should be undertaken to test the sensitivities on interest rates.
− Market conditions meant that there was the potential to achieve very competitive terms with contractors. It was important, however, that there was no compromise on quality.
− It was noted that, while a relatively small element in the overall financial appraisal, there were sensitivities around both Key Worker Housing and collegiate accommodation rental levels. Significant work had already been undertaken to benchmark collegiate accommodation rental levels against those in the Colleges and in the open market. This work would be continued in discussion with the College rental group. Rent levels for Key Worker Housing were based on government and local authority criteria for social housing and were determined as a condition of planning consent. Individual cases would be assessed against the qualifying criteria.

The Committee agreed that the update report and the latest financial appraisal and assumptions were an appropriate basis on which to progress the project.

Action: Director of Finance; North West Cambridge project team

(ii) Memorandum of Understanding

The Committee received and approved a draft Memorandum of Understanding (paper FC(12)68) between the Committee and the West and North West Cambridge Syndicate.

60. External Finance

(i) The Committee received (as paper FC(12)69) an updated paper prepared by Rothschild on financing considerations for the NW Cambridge development and the Capital Plan.

Mr Burkitt reported. The paper provided a comparison between the updated Turner Morum model for the North West Cambridge project and the previous iteration. The updated model included rental revenue streams from University private housing and Collegiate accommodation and had more nuanced inflation assumptions. The revised model, assuming interest at 5.25%, indicated that the peak borrowing requirement for the project had reduced by
£23m to £369m and that final borrowing in 2034 had reduced by £79m to £288m. It now seemed that interest at 5.25% might be an unduly conservative estimate; comparative figures were therefore provided for an assumed interest rate of 4.25% on the first £200m and 5.25% on the subsequent debt. This would reduce the peak borrowing by a further £21m and the 2034 requirement by a further £70m. A key parameter was that the amount of external borrowing taken on with respect to North West Cambridge project should be limited so that net revenue from the project would cover interest by a margin of at least x1.25 once in steady state; the revised modelling showed interest cover of x1.9 over the period. Further, the new model showed interest cover rising above x1.25 four years into the project and continuing to rise consistently and strongly over the period. A lower interest rate on the borrowing would, obviously, improve interest cover more rapidly still. These revised figures meant that the requirement in terms of the injection of internal resources was significantly reduced; a notional £47m of own funds could be needed between 2015 and 2019. However, the timing and the extent could be re-evaluated to take account of project progress and updated financial forecasts. The University might, instead, choose to take on further external borrowing. The analysis suggested that the entire project could be delivered on pre-funding with a £200m bond. Some limited short term borrowing would be necessary from 2020. It was noted that £200m was the minimum size for a public bond issue. Bonds were conventionally issued in multiples of £25m. A bond of £250m or higher would be more attractive to investors and would appeal to a larger investor base. It was noted that Barclays had recently indicated that issuing below £250m could cost up to an additional 100bps.

Rothschild’s suggested financing strategy was, therefore, that the University issued a >£250m bond in the autumn of 2012, subject to market conditions. This would represent £200m for the North West Cambridge project, with the remainder for the capital plan.

The following points were amongst those made in the course of discussion:

- There was a strong case for pre-financing as soon as possible in order to secure current interest rates. Should the Regent House choose not to Grace the North West Cambridge project, the funding could be applied towards the capital plan, in contributions against pension fund deficits or invested in CUEF.
- Borrowing rates were one of the major sensitivities in the North West Cambridge project financial appraisal. Pre-financing meant that this sensitivity could be resolved.
- Future demand on the capital plan was such that, once the £100m borrowing limit was reached, it was likely to remain at that level for the foreseeable future. It was vital that work on the capital plan continued and that the University retained the financial flexibility (including by borrowing) to be able to do so.
(ii) The Committee received (as paper FC(12)70) an updated paper on preparation for a bond issue.

The Director of Finance reported that Moody’s rating agency had visited the University on 20 and 21 June 2012. Moody’s internal rating committee had met on 10 July. The resulting rating would remain confidential and would not be published until the University instructed publication.

The Joint Head of the Legal Services Office reported that a request for proposals for legal work on a bond issue had been sent to various law firms. Clifford Chance had been chosen to advise the University on the bonds and capital markets process. It would be suggested to bookrunners, once appointed, that they use Linklaters as their lawyers.

Mr Burkett noted that the draft ‘request for proposals’ for bookrunner investment banks, which had been provided to the Committee with the circulated papers, set out proposed terms, conditions and structures. This would be circulated to a long list of banks. Rothschild recommended that the University mandate two or three joint bookrunners.

Rothschild had considered private placement as an alternative source of long term fixed rate funding. However, a covenant would almost certainly be required by private placement investors. Over a long loan period, this was likely, at some point, to restrict the University’s activities. Further, it was unlikely that a borrowing period of forty years would be possible with a private placement.

There were certain terms and conditions of which the University would wish to be aware. Investors would want a ‘negative pledge’ on an unsecured bond. This meant that if, in the future, the University issued a secured bond, it would be required to share that security with these bondholders. This provision would not apply to secured bank debt. Secondly, in the event of the University’s default on the repayment of any other significant debt (or of insolvency), there would be a requirement for the immediate repayment of the bonds in full. Thirdly, while there would be a technical provision for the early repayment of bonds, it would be prohibitively expensive. Finally, it had been agreed that the bond would be targeted at institutional investors only.

In the course of discussion, the Committee considered the period of borrowing. It was agreed that the request for proposals should ask potential bookrunners to consider various options. However, there was a preference for a forty year bond. It was therefore agreed that the financing chart should be extended to cover a forty year loan period.

In conclusion, the Committee agreed to recommend the financing proposals and a public bond issue of £300m to the Council. It was further agreed that the scheduled meeting of the Finance Committee Business Sub-Committee on 19 September 2012 should be a meeting of the full Finance Committee.

Action: Director of Finance, Rothschild
(i) Cambridge Enterprise Follow-on Fund.

The Committee, at its meeting on 9 May 2012, had received a proposal from Cambridge Enterprise for the establishment of a follow-on fund with external investors. The Committee had requested a more detailed paper and had established a working group to work with Cambridge Enterprise to develop the proposal. An update paper was now received (as paper FC(12)71).

Dr Raven reported. The paper set out in detail: the rationale for the proposal; the benefits and risks for all parties; and the fund characteristics (including fund size and timescale, investment strategy, management, fund structure and investors). It addressed the concerns which the Committee had expressed about the potential for a conflict of interest between the imperative to deliver a return to investors while still supporting the work of inventors and the University. On the question of fund size, the working group had concluded that £30m was viable in the first instance, with the potential to raise further funds in subsequent rounds once a track record had been established. It was noted, however, that those investors with whom Cambridge Enterprise was already in discussion had indicated that it might be possible to establish a larger fund (perhaps £50m) from the outset. There was considerable evidence (both documented and anecdotal) for the need for such a fund.

Ms Coutu and Professor Gilligan had served on the working group. Both considered that the revised paper and proposals met the Committee’s earlier concerns and they supported the establishment of the follow-on fund.

The following points were amongst those raised in the course of discussion:

- The decision to establish the fund was a significant one for the University. While recognising the need, there was a risk that it could be perceived as a first step towards University involvement in the financial products market. It was noted, in this regard, that investors would have no preferential access to the IP. Further, investors in funds of this type were likely to have an understanding and appreciation of the wider research and commercialisation agenda.
- The need for such a fund was, in part, indicative of the long-term challenges which Universities had faced in establishing appropriate mechanisms for investment in IP. Cambridge had maintained (and would continue to maintain) realistic expectations as to the financial returns from such investment. It was important that investors in the follow-on fund were similarly realistic.
- The follow-on fund was only one mechanism by which Cambridge Enterprise might provide follow-on support to inventors.

It was noted that CUDO would not be involved in any way in identifying investors in the follow-on fund.
In conclusion, the Committee approved the establishment of a Cambridge Enterprise follow-on fund on the basis set out in the paper.

(ii) Cambridge Enterprise annual budget: 2012-13

The Committee received (as paper FC(12)72) a paper setting out Cambridge Enterprise’s annual budget for 2012-13. It was noted that the annual submission of the budget was required by the Memorandum of Understanding. It was intended, in future years, that an initial iteration would be provided to the Finance Committee at its January meeting in order to inform later discussions at the Resource Management Committee. The Committee would also expect to see five year financial projections. The Committee approved the budget for 2012-13.

(iii) IPR revenue distribution policy

The Committee received (as paper FC(12)77) a draft Joint Report and proposed Ordinance for a revised IPR revenue distribution policy.

The Senior Pro-Vice-Chancellor reported. The committee established to review Cambridge Enterprise had brought forward various recommendations which a subsequent working group had considered. This working group had, *inter alia,* undertaken modelling to establish the financial consequences of lowering the threshold in the current distribution policy by which inventors received 90% of the proceeds. The financial impact, in practice, was limited. Under the current distribution model, a relatively small number of departments received a significant financial return but every department (including those which were unlikely ever to generate income from licenses) effectively contributed, by means of a top-slice, to the Chest funding to Cambridge Enterprise. It had therefore been agreed that consideration should be given to a more flexible mechanism for setting the balance between the Chest and Departmental share of the University’s income. The circulated Report and proposed Ordinance set out proposed new arrangements by which the Finance Committee would review the share ratio between Chest and Departments annually. None of the proposed changes would affect the inventor’s share.

The following points were amongst those raised in the course of discussion:

- The current revenue distribution acted as an incentive both to individual inventors to commercialise research and to departments to encourage entrepreneurship. The issues were not, therefore, purely financial.
- Relatively few departments benefitted to any appreciable extent from the current distribution model.
- The matter under consideration was one of internal accounting and related entirely to the distribution of the funds coming into the University. The process of setting a strategy and budget and agreeing a Chest allocation for Cambridge Enterprise was entirely separate.
There was no presumption that the current distribution would change. The proposal was simply to provide greater flexibility for the future. The Finance Committee would review the share ratio annually on the basis of the latest revenue predictions and a five year business plan. The review would be based on total predicted income.

In conclusion, the Committee recommended the draft Joint Report on the amendment of the Ordinance relating to Intellectual Property Rights to the Council and the General Board.

**Action:** Director of Finance

### 62. Accounts

**Management Accounts 2011-12**

The Committee received the Management Accounts (Paper FCBC(12)27) for the third quarter 2011-12 which had been considered in detail by the Finance Committee Business Sub-Committee on 6 June 2012, together with a summary statement to May 2012 (Paper FC(12)73). Trends continued as previously reported.

### 63. Financial Statements

The following papers were received:-

- Paper FC(12)74 Paper on the accounting policies to be applied for the 2011-12 financial statements.
- Paper FC(12)75 Paper on International Financial Reporting Standards

The Committee approved the accounting policies for the 2011-12 financial statements and noted the progress on IFRS.

### 64. Insurance

**Renewal 2012**

The Committee received proposals for insurance renewal (Paper FC(12)76). The Committee approved renewal of the insurance programme as set out in the paper but agreed that a further paper concerning kidnap and ransom cover should be brought back to the Committee at a later meeting.

Vice-Chancellor
19 September 2012
Finance Committee 11 July 2012: Straightforward and reported business submitted for decision or report

Paper No.

1. Finance Committee Business Sub-Committee

Minutes – 6 June 2012. To be approved at the next Sub-Committee meeting. For information

2. Committees

Received the Minutes from the following Committees:

Planning and Resources Committee – 23 May 2012
Investment Board – 30 May 2012
Financial System Committee – 27 June 2012

Noted.

3. GMEC Management Company Limited: Membership

Recommended to Council to appoint Professor Patrick Maxwell vice Dr Malcolm Edwards

4. Pensions

USS

Annual Report and Accounts. Received the information and agreed that the attached draft Notice be published in Reporter.

Noted.

5. Internal Loans

Annual Report

Noted

6. University’s Cash Balances and Authorised Investments Limits

Noted

7. Sealings

Note