University of Nottingham
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UCU Alternative Financial Strategy March 2021

UoN Response

March 2021

Summary

Overall summary of our response:

- our overarching priority is for sustainable financial management and investment for the future of our staff, students, teaching and research;
- counter to the ‘alternative strategy,’ the future of our University is not best served by increasing levels of debt, which would place additional burdens on future generations of students and staff;
- indeed, increasing debt only serves to increase annual interest payments which in turn would require greater not fewer financial efficiencies and restrict our ability to invest;
- as an institution, we are keen to invest in our future, but will do so within our means, rather than becoming reliant on increased financialisation and private lenders - trends that UCU itself has strongly objected to over the past decade;
- our day-to-day treasury model is based on cash management that reduces costs while maintaining liquidity, we have ample access to cash where required and believe that the UCU Branch has misunderstood this model;
- leading credit rating agency Standard & Poor’s performed an in-depth review of our financial arrangements last year and commented that “The University of Nottingham has improved its financial resources, putting it in a good place to weather COVID-19 related headwinds.”
- UEB sub-committees make most investment prioritisation recommendations and since 2018, these committees have included nominated members of staff from all job families. In 2020 we increased the number of such members on most committees. Council includes representatives from senate. Investments greater than £5m but less than £10m have to be approved by Finance Committee, and investments over £10m have to also be approved by Council – meaning there is a high level of scrutiny of any investment made by the University.

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Alternative Financial Strategy

UCU has provided two documents on UoN finances, which were not shared or discussed at previous meetings between UCU and UoN

- “An alternative financial strategy: establishing sustainable finances at University of Nottingham”
- “Alternative financial strategy – technical document”

In summary “*UoN UCU demands that UoN abandons its ‘lean financial management’ and replace it with a strategy based on careful, long-term borrowing for key investment projects, supported by broad consultation amongst staff and finalised in a democratic decision-making process that involves the university community (universitas) as a whole. This should involve the University agreeing a budget for 2021-22 that reflects the principles and approach set out in UCU’s Alternative Financial Strategy.”*

Alternative Financial Strategy

UoN UCU Alternative Financial Strategy has 3 components

1. *Long-term borrowing for key projects, including infrastructure and investment*
2. *Changing financial strategy, including 'lean financial management'*
3. *Increasing broad consultation and 'democratising investment decisions'*

We consider each of these components in turn in light of our university strategy and financial strategy

University Strategy

Mission

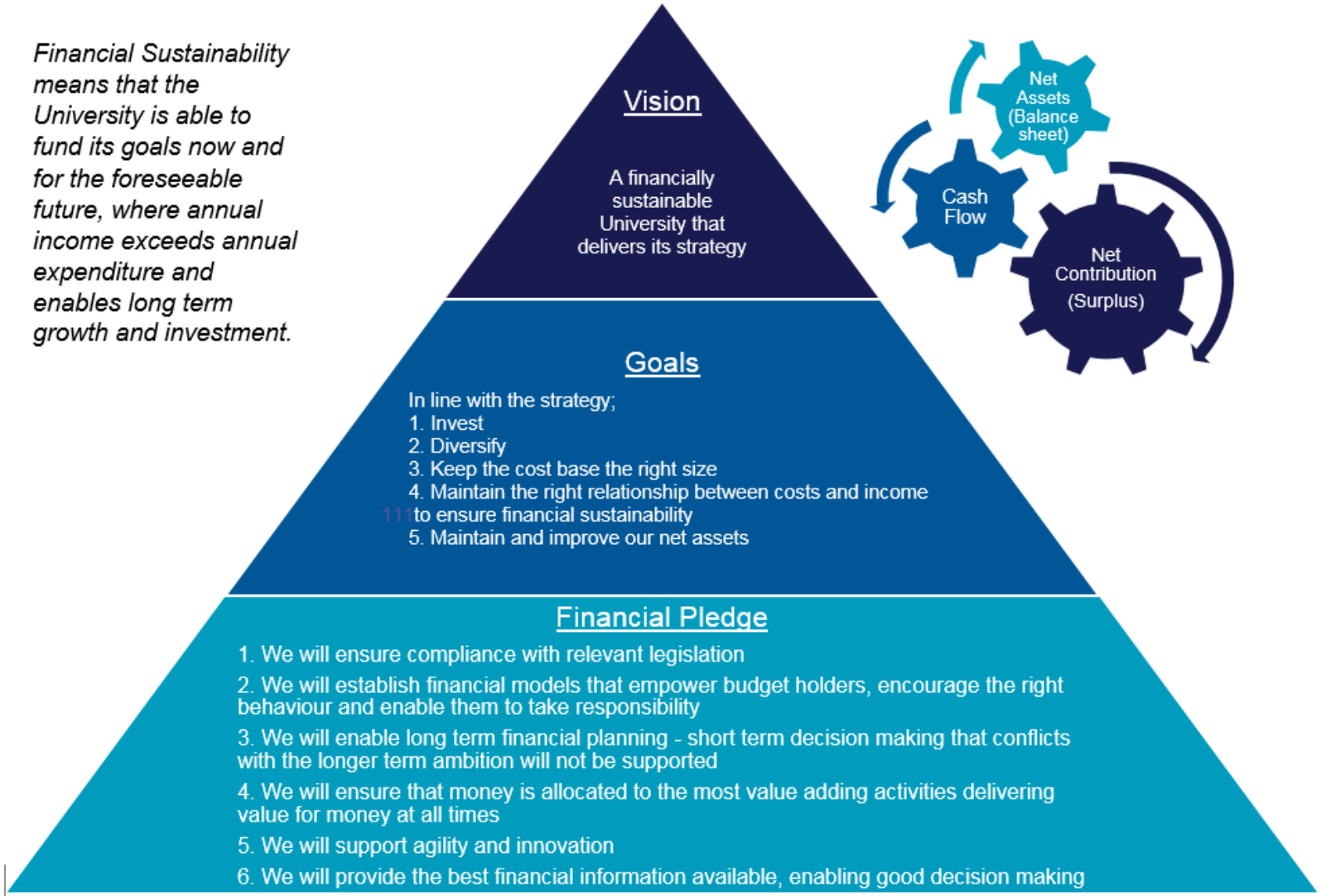
- We have inspiring campuses in three countries, energising us to be a globally engaged university that is also committed to making a difference in our cities and regions
- We empower and support students and staff to collaborate in learning, scholarship and discovery across all realms of knowledge, solving problems and improving lives
- We are stewards of a pioneering and entrepreneurial tradition of creativity and innovation

Our vision is:

to be a university without borders, where we embrace the opportunities presented by a changing world, and where ambitious people and a creative culture will enable us to change the world for the better.

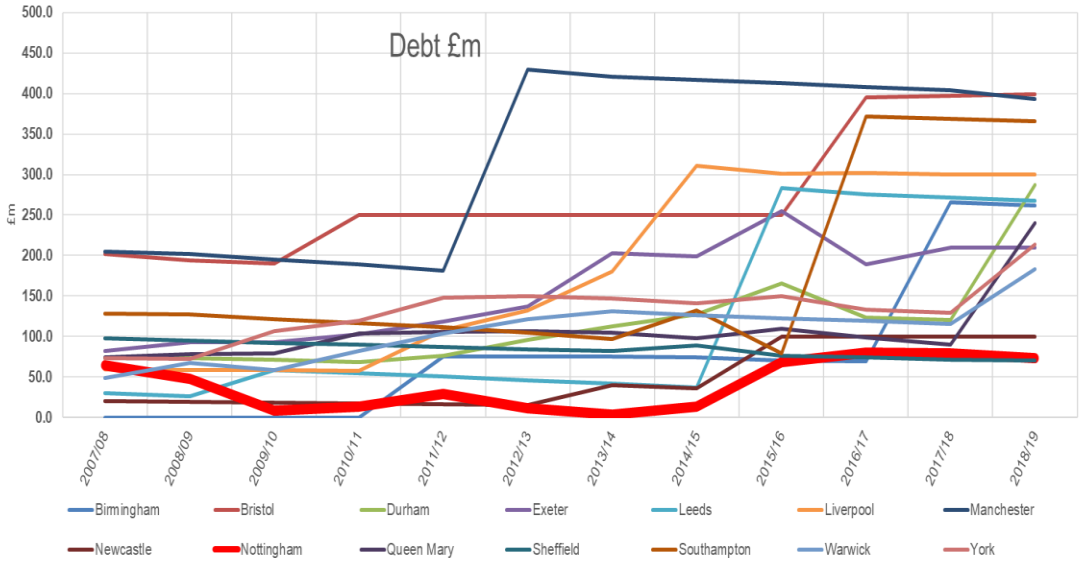
Financial Strategy

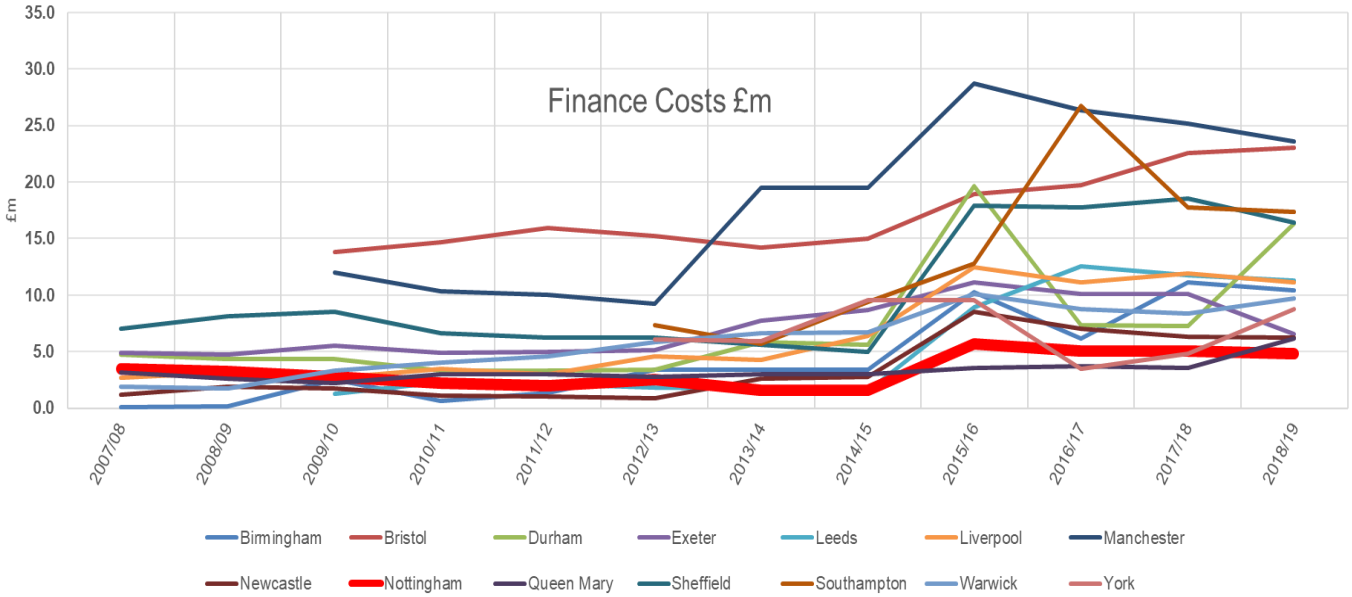
Financial Sustainability means that the University is able to fund its goals now and for the foreseeable future, where annual income exceeds annual expenditure and enables long term growth and investment.



1. Why UoN maintains low debt- UoN keeps it annual financing costs low versus the sector

For context, UoN entered the Covid-19 period with low debt, and therefore **low associated finance costs** (most recent HESA data for 2018/19). UoN financing costs were lowest in the sector. This means that other Universities pay up to £22m in interest pa where UoN pays less than £3m.





Why UoN maintains low levels of debt – interest payments are a financial burden

- The previous chart shows that UoN interest payable is approx. £2.5m per annum compared to other Universities that are paying interest of up to £22m.

- If interest rates go up by 1pp - on £100m of debt, the interest payable increases by £1m pa. This applies to variable rate debt.

- Although the bank base rate is low at the moment, when lending money, banks add a 'margin' onto the base rate to allow for their perceived risk of making the loan. This means that the interest rates achieved on debt are always considerably higher than the bank base rate or the gilt rate.

- When assessing risk, banks will need to understand an organisations ability to repay the debt and to pay the annual interest payment – they will need to know that an organistion has a plan to repay the debt.

1. Why UoN maintains low debt– UoN's Credit rating shows that we are adopting a low risk strategy

S&P Global
Ratings

RatingsDirect®

Research Update:

U.K.-Based University of Nottingham 'A+' Rating Affirmed; Outlook Stable

June 19, 2020

Overview

- The University of Nottingham (Nottingham) has improved its financial resources, putting it in a good position to weather COVID-19-related headwinds.
- While uncertainty plagues the enrolment of overseas students, Nottingham's strong reputation should continue to attract domestic students.
- We are therefore affirming our 'A+' long-term issuer credit rating on Nottingham.
- The stable outlook reflects our expectation that the university will successfully achieve its identified cost savings, easing pressure on its financial resources.

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A low debt position supports our high credit rating

During June 2020, Standard & Poor's undertook their annual credit rating review of the University.

They have affirmed our credit rating at an A+.

This demonstrates that we are adopting a LOW risk financial strategy – contrary to UCU's view that our financial strategy is HIGH risk.

1. Why UoN maintains low debt– UoN use debt instruments carefully to provide good liquidity

For context, UoN has used debt instruments and continues to use debt instruments in line with our financial strategy.

Over the past two years, we have

- Undertaken a private placement of £100m over 30 years at a competitive interest rate
- Maintained flexible credit facilities from banks
  - Overdraft of £15m
  - Revolving Credit Facility of £80m – 10 years
- Increased our options to borrow taking advantage of the 3 year CLBILS scheme (£60m)

These facilities together provide significant headroom for future financial headwinds

1. Why UoN maintains low debt – so we have 'light touch' covenants

USS are looking at introducing covenants so that they can test the financial strength of Universities, if introduced we will have to monitor and report against these at least annually, in addition to those set with lenders.

These are more severe than our own covenants and are more like the covenants that other Universities with higher levels of debt have to comply with. Many Universities will breach some of the covenants immediately.

This is the 2020/21 forecast 2 (January 2021) position against those covenants;

Covenant A - Gross debt to Net assets less than 50% - ours is 12% - we would breach this if debt went above £240m
Covenant B - Gross debt to Total income less than 50% - ours is 13% - we would breach this is debt went above £330m
Covenant C - Gross debt to Net Operating Cashflows must not exceed 5 times - ours is 2.9 times – we would breach this if debt went above £150m
Covenant D - Net Operating Cashflows must be at least 4 times interest payable - ours is 10 times – we would breach this if interest went above £7.5m (equates to approx. £300m of debt)
Covenant E - Gross Secured Debt to Net Assets must be less than 10% - ours is 0% as we have no secured debt – we would breach this if we had secured debt of £47m

If we breach all of A-D it will result in closer monitoring by USS
If any 3 of A-D are breached in consecutive years it will result in closer monitoring by USS
If E is breached in any one year it will result in closer monitoring by USS

If many Universities breach the covenants, then USS would have to consider either putting costs up across the sector for members as well as employers or benefits reform

Increasing long-term borrowing – why not.

We fundamentally disagree that UoN should increase long-term debt, and think it would be foolish to do so at a time of uncertainty for the **economy** and the **sector**. Increasing indebtedness would compromise our **short-term** and **long-term** freedom and viability as an institution

In the **short-term**:

- Increased interest burden, reducing our ability to support day-to-day activities
- Restricted financial flexibility due to additional debt covenants, including provisions regarding holding additional cash, which may see us need to *increase* our cash holdings and *limit* day-to-day spending
- Reduced capacity to strengthen USS covenant, leading to increased employer and employee contributions and additional uncertainty over the viability of the scheme
- Reduced entitlement to (interest free) government support schemes in emergency scenarios

Increasing long-term borrowing- why not.

In the **long-term**:

- Increased interest burden and burden of repaying debt over the long term, resulting in the university reducing resources for future students and staff in order to make repayments
  - Repayments must be paid for out of future surpluses: resulting in reduced spend on teaching and research, staff and people, students and facilities, or increased commercial income targets

- Exposure to interest rate variation, whereby increasing interest rates would add a debt repayment burden to the university and further reduce resources for day-to-day activities.

- Reduced capacity to absorb deficits arising from USS and contribute to a sustainable pension offer for staff. Reduced ability to strengthen long-term covenant of USS and contribute to deficit recovery

- Increased exposure to lenders and long-term implications of covenants. Our university strategy would become financialised and increasingly dictated to by the long-term interests of financiers

Considering these long-term challenges, we are surprised that UCU at Nottingham is arguing in favour of increased institutional indebtedness. These are the very dynamics in parts of the sector that UCU has been campaigning *against* over the past decade.

Increasing long-term borrowing – why has UCU changed its position?

UCU have argued for more than a decade that universities are over-reliant on debt

- UCU has convened a series of campaigns aligned against the perceived debt-fuelled expansion at UK universities. UCU has made persistent representations against indebtedness via the Joint Negotiating Committee for Higher Education Staff working group on “The Financial Health and Sustainability of the HE Sector”

- UCU-commissioned “McGettigan Report” 2020: “*exposes a strategy on the part of University Executive Groups (UEG) of prioritising debt-driven expansionism over academic vision, the welfare of its employees and students, and the long-term sustainability of the institution*.” (Andrew McGettigan, author of “The Great University Gamble Money, Markets and the Future of Higher Education”

Why has UCU changed it’s position on debt and financial sustainability?

2. Changing financial strategy

UCU argues UoN should change day-to-day financial strategy

Our headline response to this:

- UoN strategy for maintaining day-to-day treasury is financially efficient and flexible, reducing costs and allowing us to maximise our resources
- UCU may misunderstand the distinction between cash and liquidity: entering the Covid-19 period we were mid-rank in RG for available liquidity
- Our day-to-day financial treasury is independent of our long-term financial strategy, we cannot “replace” our treasury model with long-term debt as these are separate issues (managing liquidity vs managing debt)
- At no point have we come even close to breaching our OFS liquidity requirements

We consider the specific points raised by UCU in turn:

2. Changing financial strategy – the specifics

Union Challenge: The way UoN manages its banking is controversial and high risk.
Our response: This is factually incorrect. UoN have managed its banking in this way for years and it is not controversial, it is in fact the norm outside of the sector. The medium term financial plan and financial strategy is scrutinised and challenged before being approved by UEB, Finance Committee and Council. We have a low risk strategy due to our low levels of debt.

Union Challenge: UoN has not set a financial strategy that supports its charitable purpose - it shouldn't be driving efficiency.
Our response: This is factually incorrect. Being a public sector organistion and a charity requires UoN to spend its money wisely, in pursuit of the charitable purpose and demonstrating value for money. The Financial Strategy that UoN has is in line with this.

Union Challenge: UoN's method of managing banking forces UoN to pursue a strategy of maximum efficiency.
Our response: UoN has adopted a financial strategy which requires it to maintain net debt levels at £100m. This means that if it is going to spend money it has to generate it and to have its greatest impact as a University, efficiency is desirable. Despite UoN's decision to maintain its level of debt, it is not as efficient as it could be.

Union Challenge: UoN's method of managing its finances caused panic decisions to cut costs when COVID hit.
Our response: This is factually incorrect. During the COVID crisis UoN has not made any compulsory redundancies, it has run promotions and regrading, it topped up furloughed salaries to 100% and it will be paying increments. If the financial situation improves further when the third forecast is done it will be able to restart the Nottingham Reward Scheme. The focus has been on protecting staff jobs – and so far it has been able to do this.

Union Challenge: If UoN had gone into COVID managing banking in the same way as other Universities it would have been in a stronger position now.
Our response: This is factually incorrect. UoN is in a strong position now because of its overall financial strategy to maintain low levels of net debt and because it has sought to manage the impact of COVID for the long term, protecting staff.

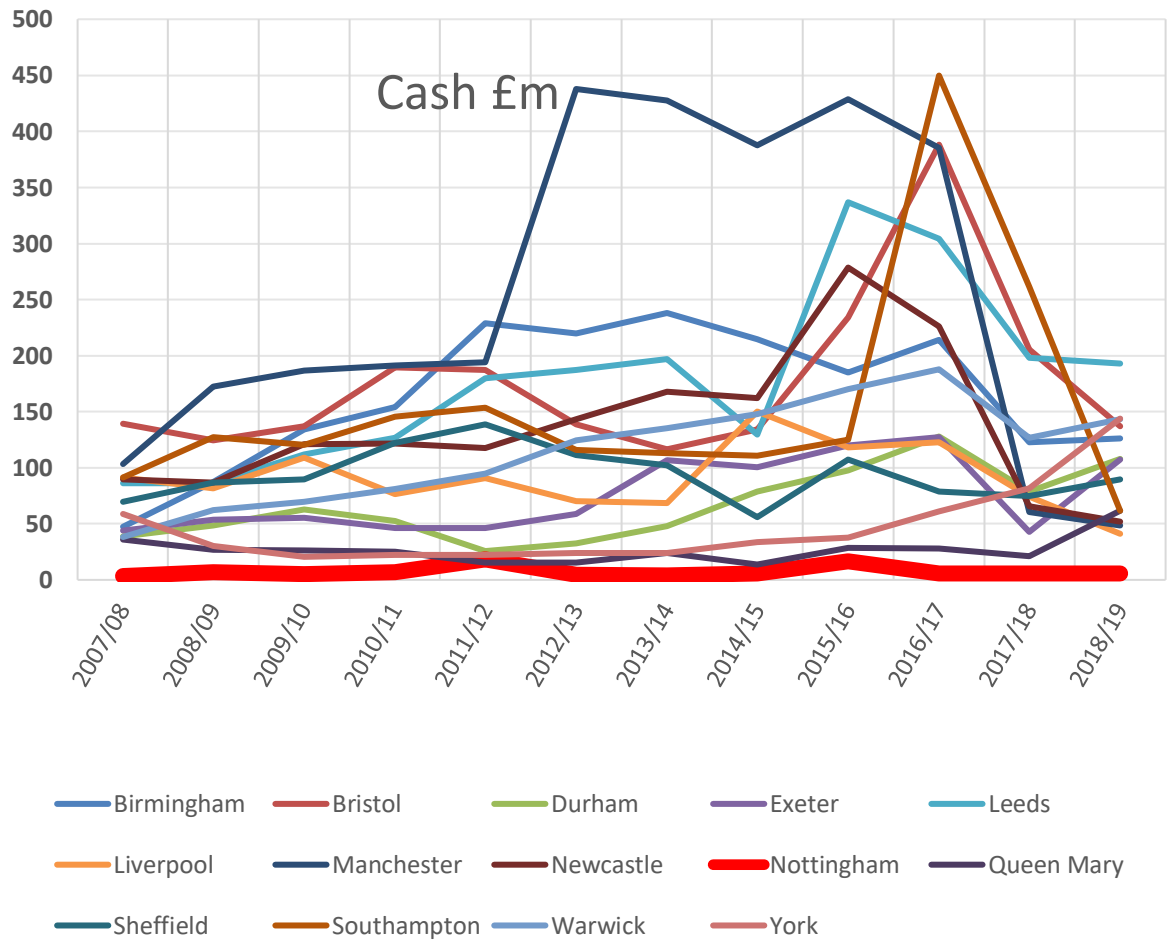
Union Challenge: UoN's financial position has improved but we are still having to make the 15% cuts.
Our response: we have reduced the 15% plans due to our commitment to not make any compulsory redundancies, agreement to pay increments, and a draw back on the requirement to improve research margin (something that would have added more pressure on faculties) – this means that the actual reductions across the whole University will be approx. 11%. Despite the slight improvement in our financial situation, our modelling shows that it will take a few years to build income back up, hence why we need the plans to be delivered in a sustainable way.

UNION CHALLENGE: The way UoN manages its banking is controversial and high risk.

OUR RESPONSE: This is factually incorrect. We have managed our banking in this way for years and it is not controversial, it is in fact the norm outside of the sector. In addition the medium term financial plan and financial strategy is scrutinised and challenged before being approved by UEB, Finance Committee and Council. We have a low risk strategy due to our low levels of debt.

- Our financial management strategy is based upon minimising interest payments while maintaining liquidity to finance day-to-day activities
- Immediately pre-Covid, our access to liquidity was mid-table in the RG - we had access to £55m cash in the UoN bank account and £95m of facilities (£80m of which is long term)– this placed us mid table with other RG Universities. As of today (19th March 2021) – we have £75m cash in the bank and additional banking facilities of £155m.
- Standard & Poor's would not give the UoN an A+ credit rating if the method of banking was in any way controversial or high risk
- At no point in the last 12 months, have we come close to running out of available cash despite an overnight drop in income, because of the banking arrangements we have in place and because of the action that we took – to reduce non essential spend (travel, equipment and repairs & maintenance)

Historic picture



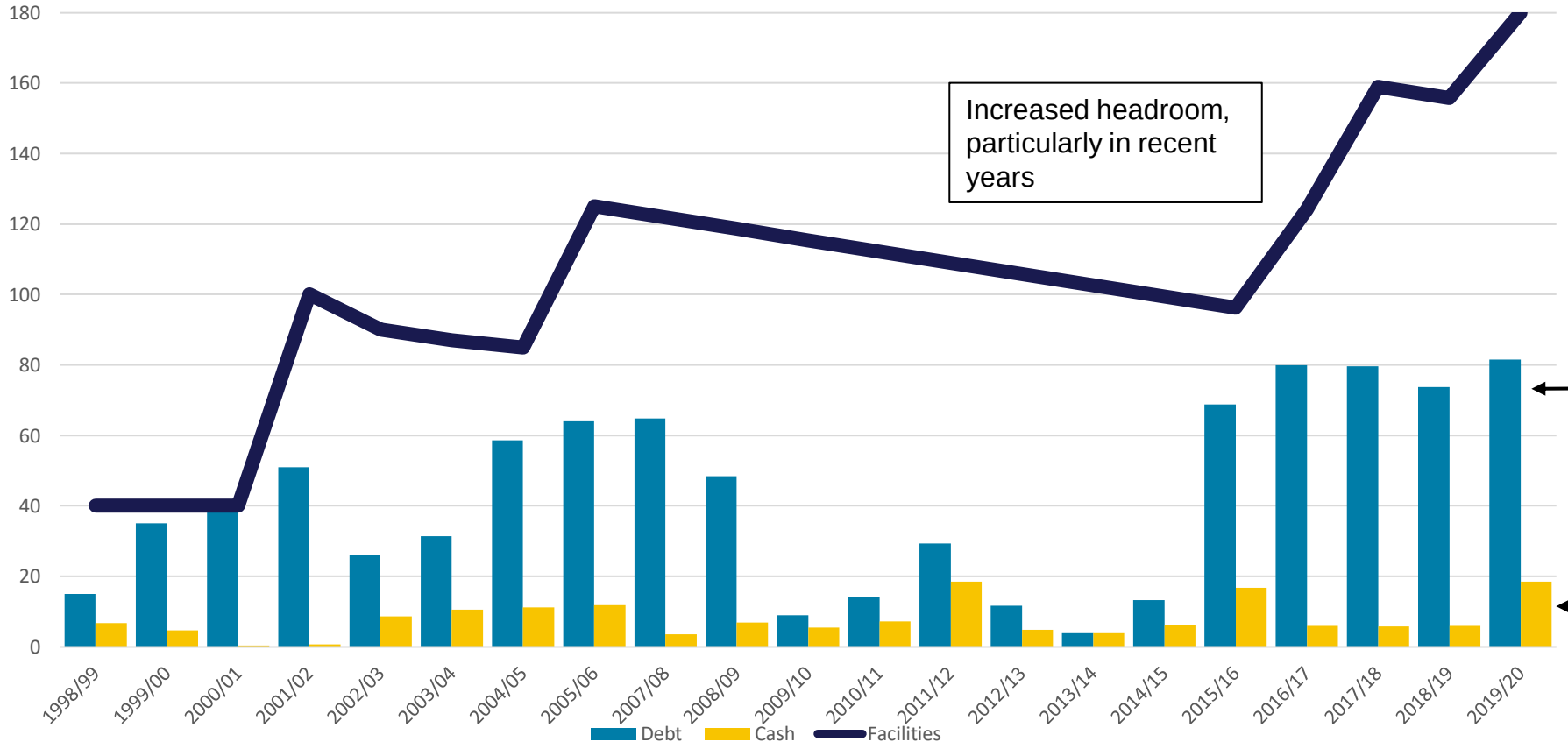
UoN went into COVID with the equivalent of £150m available liquidity that would put UoN mid table with other RG Universities.

We think UCU may have overly focused on this illustration from the HESA accounts of cash holdings.

Note this graph measures cash holdings, not liquidity (i.e. overdrafts) and could be misinterpreted as indicating UoN liquidity position was very low

Headroom over time

Looking back historically over 20 years we have managed our treasury to align with the activity of the university. Headroom has increased over time to manage increased investment demand.



Note: Headroom excludes overdraft facility of £15m

Increased headroom, particularly in recent years

Managed levels of debt

Consistently low cash levels

Treasury management models

How we manage Treasury makes no difference to our access to cash, it does however make a difference to our interest cost efficiency

Many of the RG Universities

Debt	£200m
Cash	£100m
Available facilities	£ 0m
Available cash	£100m

- £100m of available cash
- Covenants in place over the debt
- Higher net interest cost

University of Nottingham

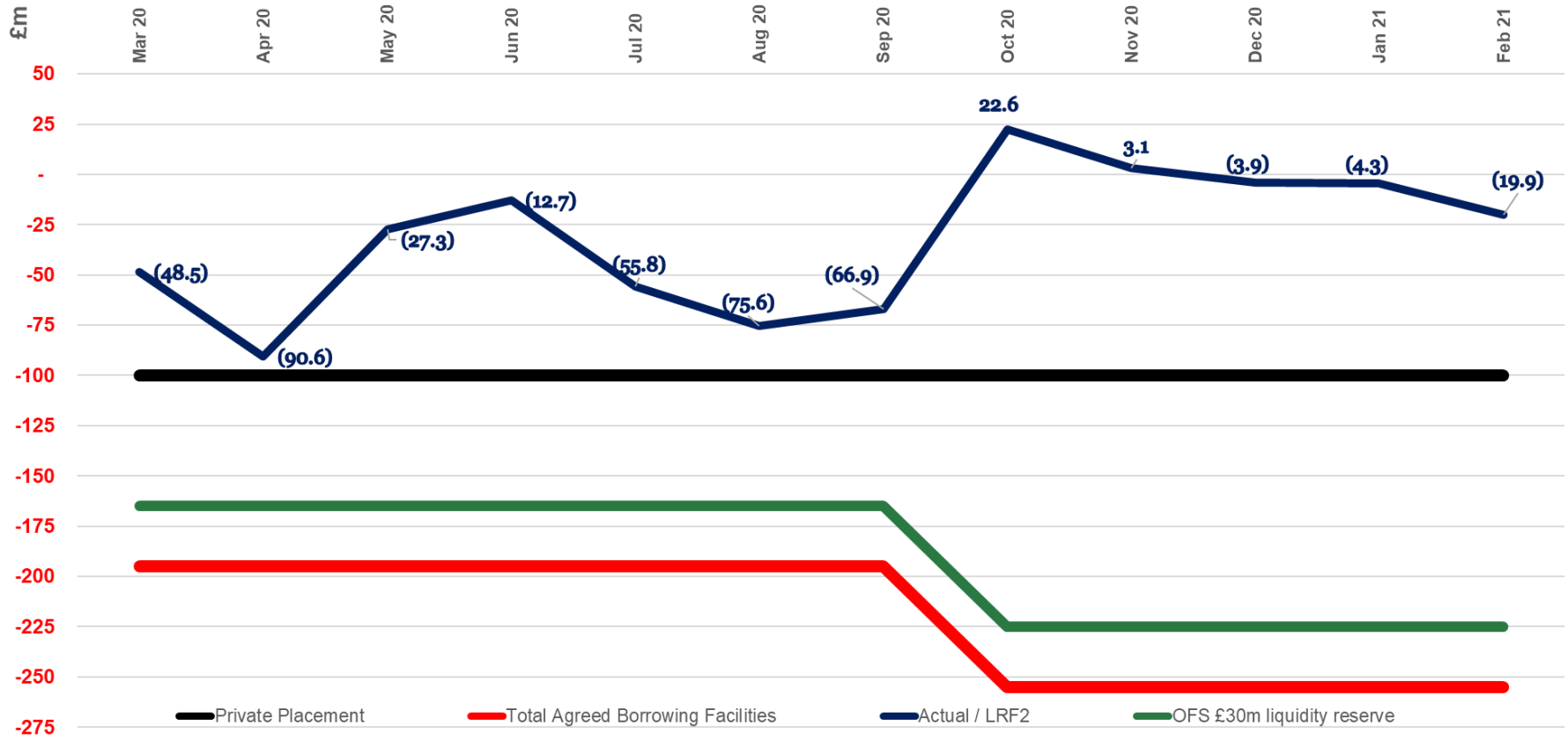
Debt	£100m
Cash	£ 0m
Available facilities	£100m
Available cash	£100m

- £100m of available cash
- Covenants in place over the debt (less restrictive due to lower level of debt)
- Lower net interest cost

We are able to manage it in this more advantageous way because many years ago we were able to arrange a longer term RCF with Natwest – this RCF is recognised across the banking sector as being one of its kind and is not something that other RG Universities have access to

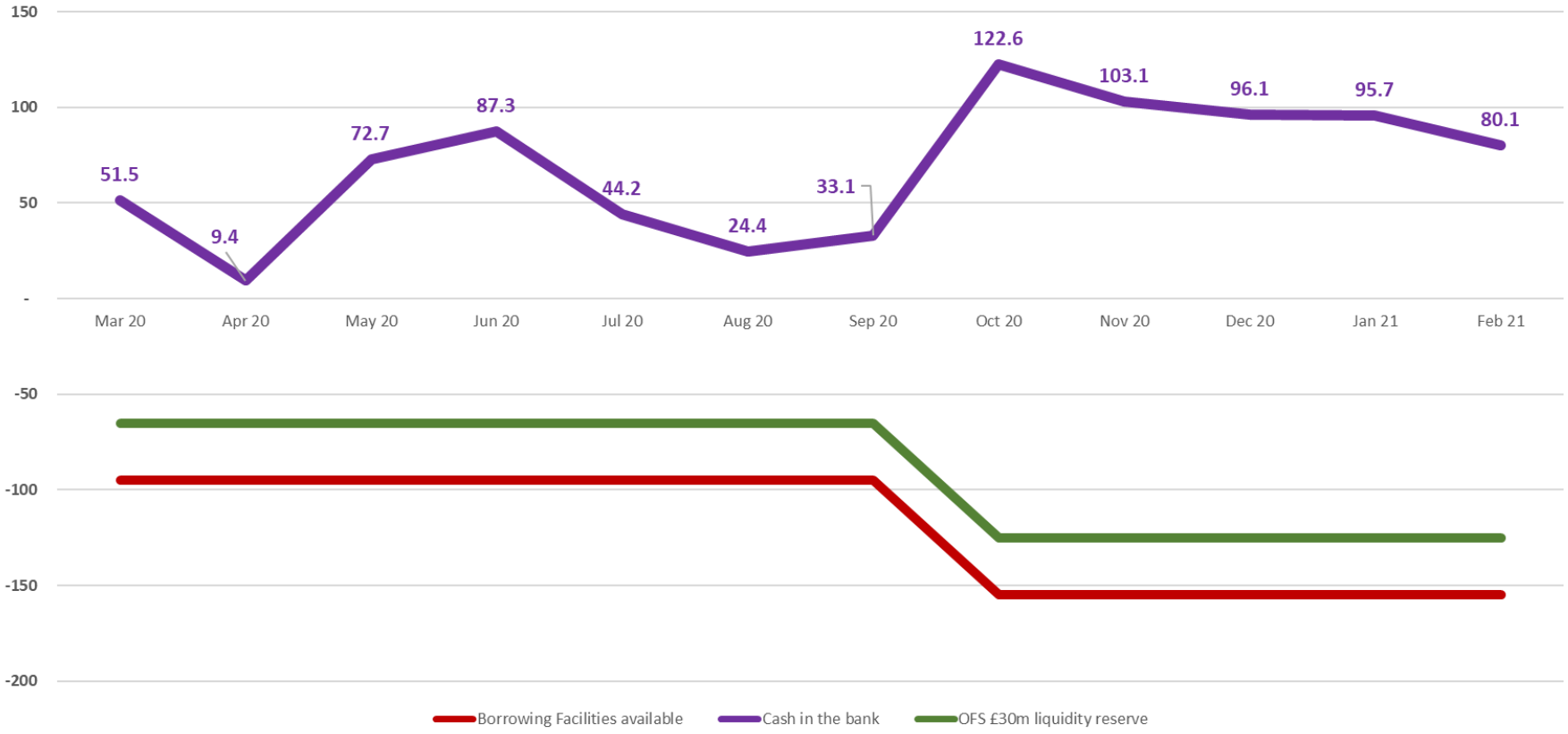
Net debt during COVID

At no point in the last 12 months have we come close to breaching the Office for Students requirement to maintain £30m liquidity.



Cash flow during COVID

At no point in the last 12 months have we come close to breaching the Office for Students requirement to maintain £30m liquidity.



UNION CONCERN: UoN has not set a financial strategy that supports our charitable purpose

OUR RESPONSE: being a public sector organistion and a charity requires us to spend our money wisely, in pursuit of the charitable purpose and demonstrating value for money.

- The vision of the University is to be a university without borders, where we embrace the opportunities presented by a changing world, and where ambitious people and a creative culture will enable us to change the world for the better
- The financial strategy is set to support this
- As a charitable trust and public sector organistion, UoN can only spend money in pursuit of the charitable purpose and must be able to demonstrate value for money
- The Office for Students, as the UoN regulator, receives financial information from the UoN on a regular basis and is content that UoN is managing its finances in line with charitable regulations
- To be clear, UoN returns no profits or dividends to private investors, all surpluses are re-invested into the University. Interest payments are returns to private lenders, which the University seeks to minimise

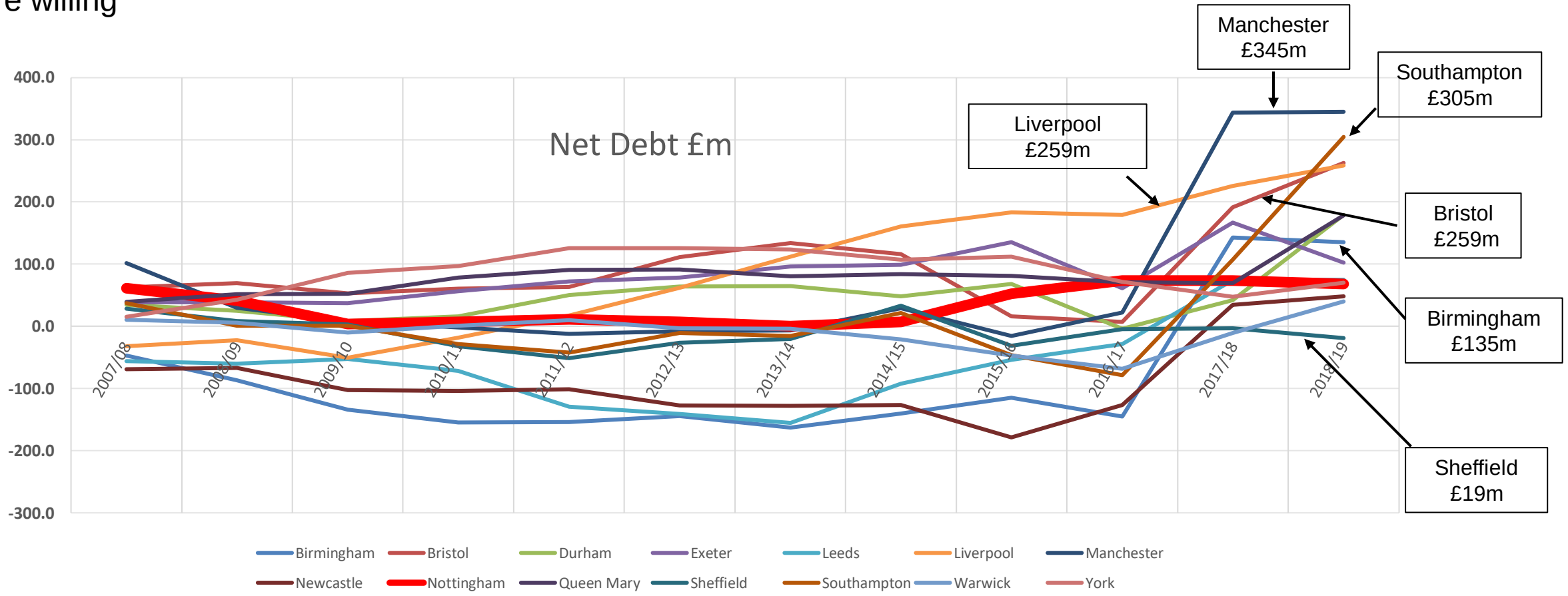
UNION CHALLENGE: UoN's method of managing banking forces UoN to pursue a strategy of maximum efficiency

OUR RESPONSE: UoN has adopted a financial strategy which requires it to maintain net debt levels at £100m. This means that if it is going to spend money it has to generate it and to have its greatest impact as a University, efficiency is desirable. Despite UoN's decision to maintain its level of debt, it is not as efficient as it could be.

- Having low net debt versus the sector puts the UoN in a strong financial position because it keeps finance costs at a minimum and reduces the impact of any covenants
- Despite managing banking in this way for approx. 15 years, and maintaining low levels of debt while funding significant investment programmes, the UoN is not as efficient as it could be.
- Using debt to fund investment (as UCU proposes in the AFS) would mean that the UoN would incur approx.£100m of extra debt a year – if this had been the case for the last 5 years, UoN would have been entering the COVID crisis with £600m of debt and no cash. This would have required more significant cost base reductions to fund interest payments, would have given no flexibility to take out further debt as part of managing the crisis and would have meant compliance with far more stringent covenants.
- The MTFP going forward puts resource back into the cost base at a faster pace than an increase in activity

Net debt efficiency

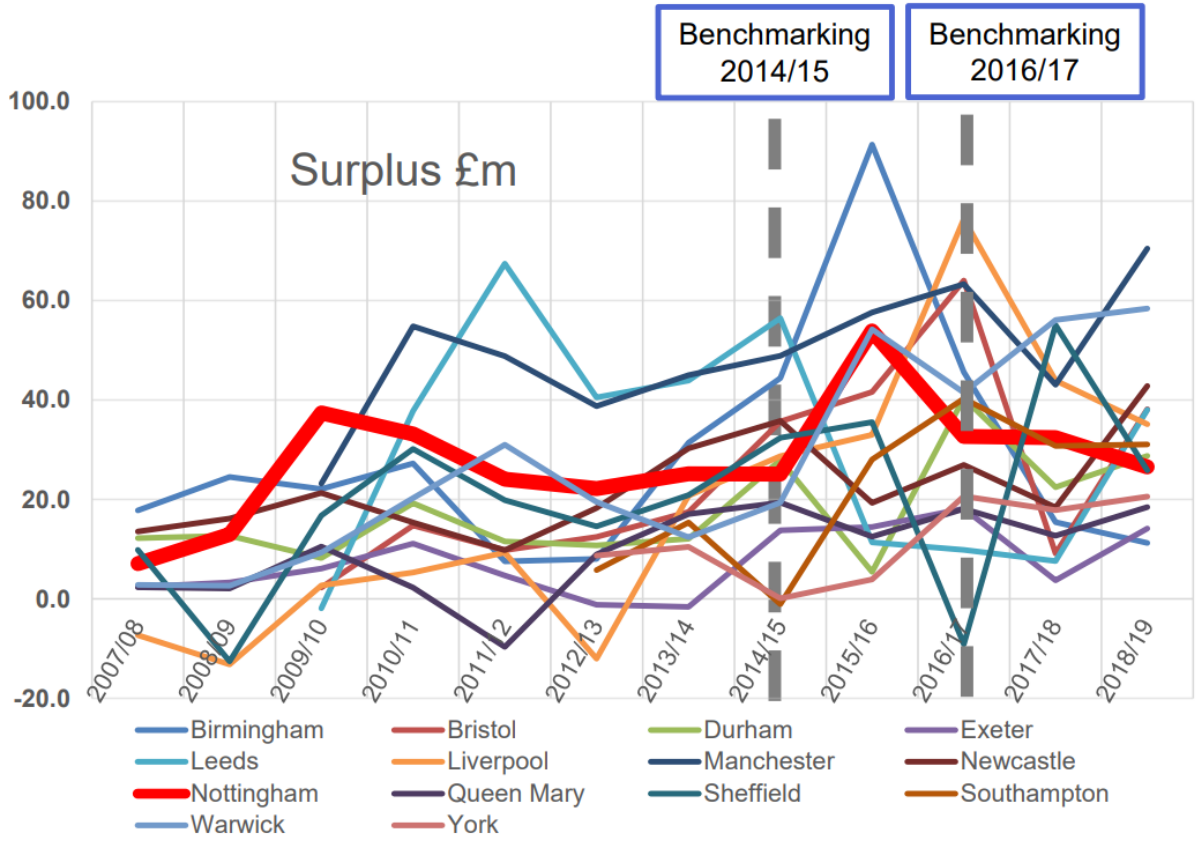
Net debt is the important number for comparison purposes and is the number we manage to (historically one of our guiding principles is that our net debt position should not exceed £100m) and we compare very favourably to the sector - this means we have more capacity to borrow should we need to and if the banks are willing

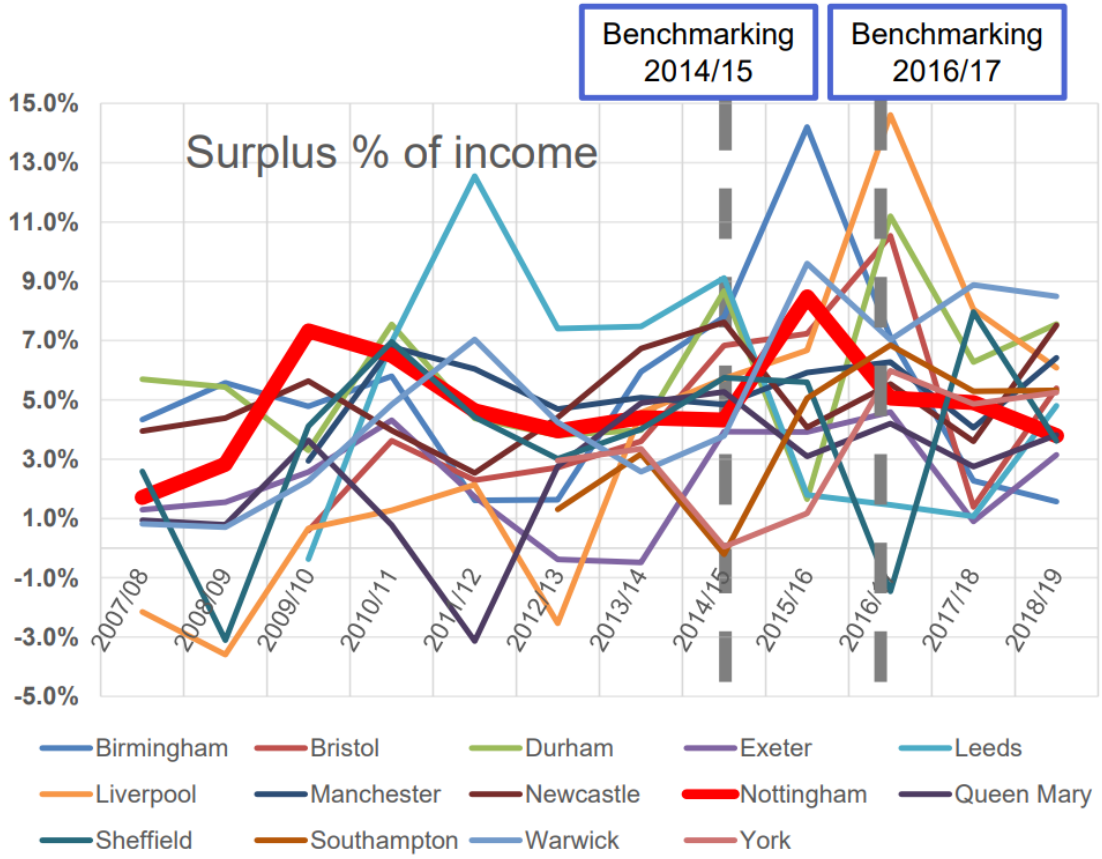


Surplus versus RG peers

Surpluses are variable across the peer group, with a general upward trend. Over time, Nottingham has moved from the upper end of the peer group to a below average position, delivering surpluses of circa £20m. Surpluses as a percentage of income follows a very similar pattern and Nottingham is towards the lower end of the peer group with percentages between 4% and 5% which is more aligned to Exeter and Queen Mary.

Warwick, Durham, Newcastle and Manchester are at the upper end of the peer group delivering between 6% and 8% surpluses

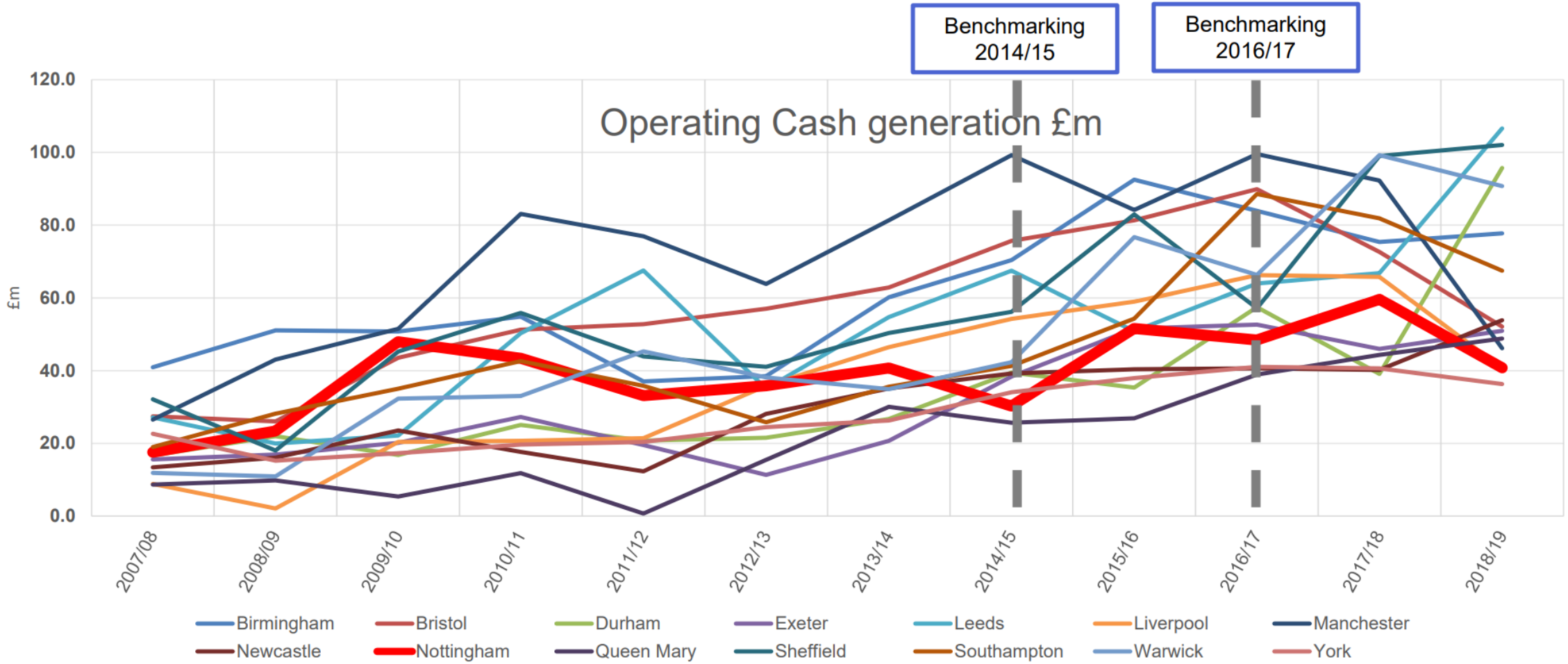




Operating cash flow £m

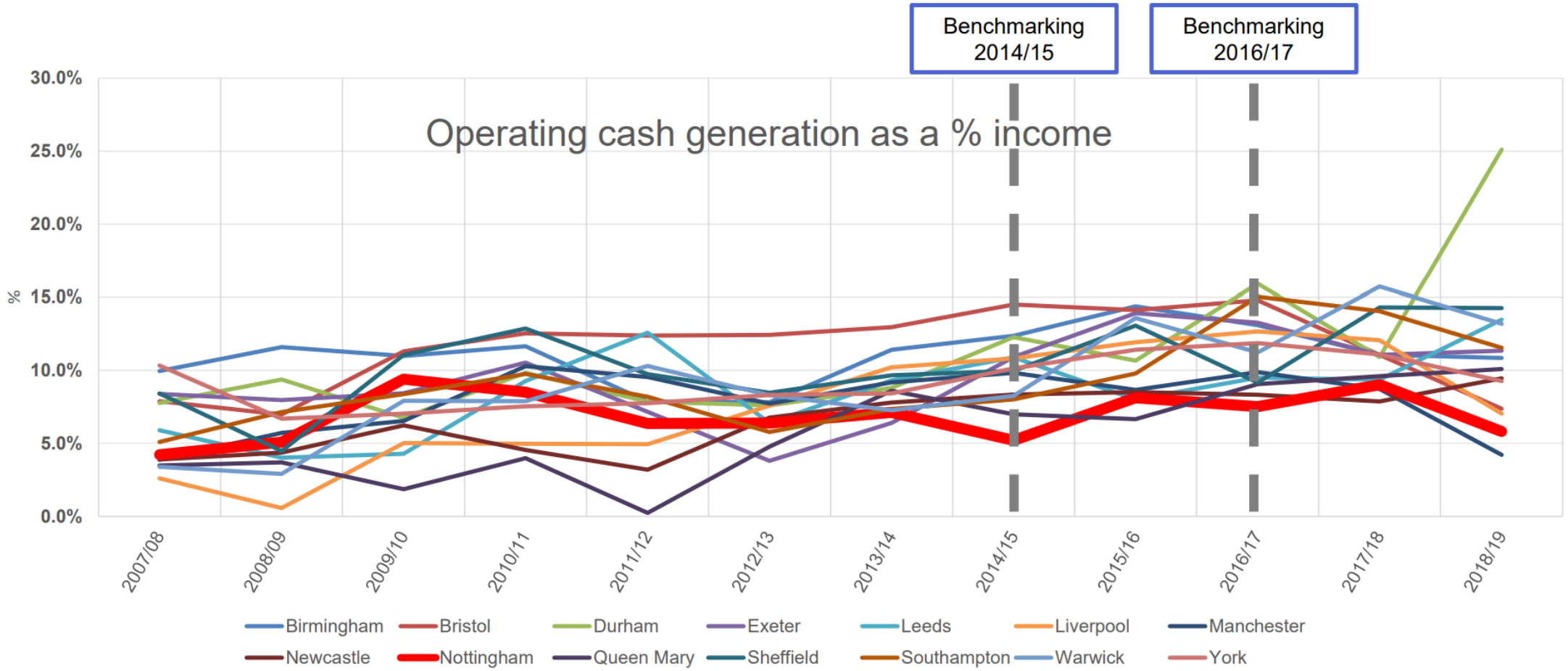
Operating cash is very inconsistent over the period. Nottingham has, over time almost fallen toward the bottom of the peer group with only York currently below. This position has worsened since 2016/17, with the operating cash in 2018/19 falling by £19m.

As one of the largest universities in the peer group the cash generated should better reflect our size.

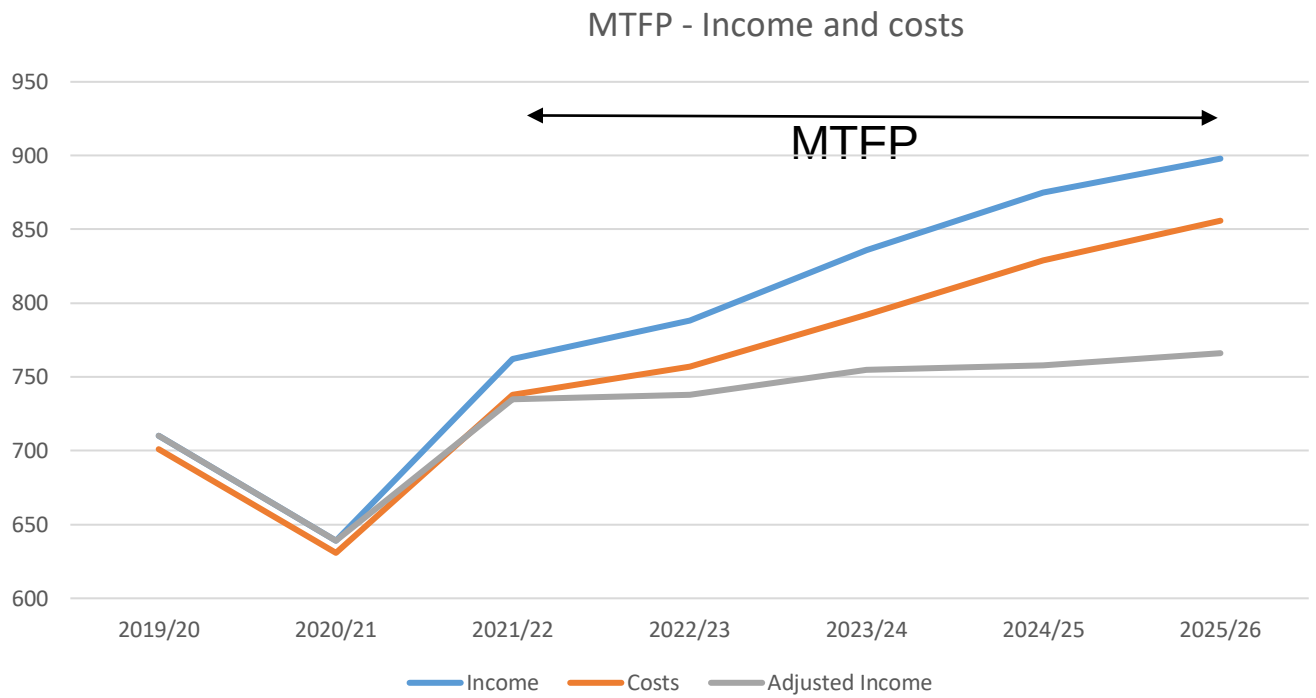


Operating cash flow as a % of surplus

In recent years Nottingham is consistently below the peer group for operating cash generation in proportionate terms, the overall percentage has risen since 2014/15, with a significant dip in 2018/19. There are generally large variations between individual years over all of the peer group.



The MTFP grows the resource base faster than activity over the next 5 years



The chart shows the university's income and costs over the next 5 years. We plan to grow income over this period not by growing the scale of our activities (e.g. taking more students) but by changing the mix of our activities, in particular by increasing the proportion of international students and by increasing research margin. Despite holding the scale of our activities constant, the university's costs will increase through inflation, USS costs and other rises in costs. The amount of additional income we gain by increasing the scale of our activity, which will rise only slightly is shown by the grey line

Union challenge: UoN's method of managing its finances caused panic decisions to cut costs when COVID hit

Our response: This is factually incorrect. During the COVID crisis we have not made any compulsory redundancies, we have provided salary top-ups to 100% under the furlough scheme, we have run promotions and regrading and we will be paying increments. If the financial situation improves further when we do our third forecast we will be able to restart the Nottingham Reward Scheme. Our focus has been on protecting staff jobs – and so far we have been able to do this.

- We have avoided compulsory redundancies and, unlike many of our competitors, have not put staff at risk of redundancy in order to save costs
- We have used the furlough scheme prudently, but have topped-up salaries in all cases to 100%, providing financial surety to our staff
- As the financial situation has improved, we have moved to pay increments and uplift, and are currently running promotions rounds
- We offered a voluntary severance / redundancy scheme to reduce medium-term costs in particular areas – note that VR/VS incurs higher up-front costs and is not an emergency measure to save money
- We hope to recommence the Nottingham Reward Scheme later this year

Union concern: If UoN had gone into COVID managing its banking in the same way as other Universities we would be in a stronger position now

Our response: This is factually incorrect. We are in a strong position now because of our overall financial strategy to maintain low levels of net debt and because we have sought to manage the impact of COVID for the long term, protecting staff.

- We think this is a completely misguided understanding of the financial situation at UK universities, but appreciate that UCU have limited data on this (relying on HESA 2018/19)
- The confusion between cash and liquidity results in the misreading that UoN entered the Covid-19 period with little available funds, this is simply not the case
- We projected income losses of up to £150m and had to act quickly, but losses have not materialised at this level and we are rebounding quickly
- It is unclear how and why entering a crisis with more debt could somehow represent a stronger position – it would have meant higher underlying interest payments, less ability to borrow and less eligibility for emergency finance schemes (which were thankfully not needed, but might have been needed in a worse scenario)
- COVID will have a multi year impact on the finances of the University – so borrowing more money in the first year will not be sufficient – the amount that would need to be borrowed would cumulate very quickly over the next 3 or 4 years.

Union concern: UoN's financial position has improved but we still have to make the 15% cuts permanent.

Our response: we have reduced the 15% plans due to our commitment to not make any compulsory redundancies, agreement not to pay increments, and a draw back on the requirement to improve research margin (something that would have added more pressure on faculties) – this means that the actual reductions across the whole University will be approx. 11%. Despite the slight improvement in our financial situation, our modelling shows that it will take a few years to build income back up, hence why we need the plans to be delivered in a sustainable way.

- As the financial situation improves, internal budgets are being increased for 2021/22 with on average ongoing savings of approximately 11%
- As incomes improves over coming years, we will continue to review internal budgets and bring these in line with the size and shape of ongoing activity

Summary of response to financial model critique

UCU's AFS is confused and misleading – there are a number of inaccuracies included in the document (e.g. we haven't published a £430m capital investment programme, VR was part of the 15% plans, there has been no freeze on promotions, the finance arrangements that we have in place are not short term)

Overall the AFS advocates for borrowing money to fund investment – if UoN had done this over the last 5 years it would now have £600m of debt – which means our covenants would be more restrictive and our interest payments would be 6 times higher – this would have made it much harder to manage the financial impact of COVID and the 15% reductions would have been even deeper.

The way that UoN manages is banking is not controversial or high risk as recognised by S&P with the A+ credit rating. Through the use of a 10 year Revolving Credit Facility UoN had the equivalent of £95m cash in the bank going into COVID - this is in line with other RG Universities.

Efficiency is a good thing because it ensures that we are delivering value for money as required by the legislation that governs us.

However, evidence shows that UoN has not been as efficient as it could or should be with much lower surpluses as a % of income than its RG peers – contrary to UCU's view that we have been delivering maximum efficiency.

The financial strategy and medium term financial plan for the UoN has been developed by financial experts with University experts – it is supported by in depth modelling and benchmarking and has been scrutinised and challenged by the University governing bodies (PRC, UEB and Finance Committee) before being approved by Council.

It is disappointing that UCU did not raise this with us during the numerous meetings that we have had with them over the past few months including just one week before the AFS was issued

3. Investment decisions

UCU argues UoN should change processes for investment decisions

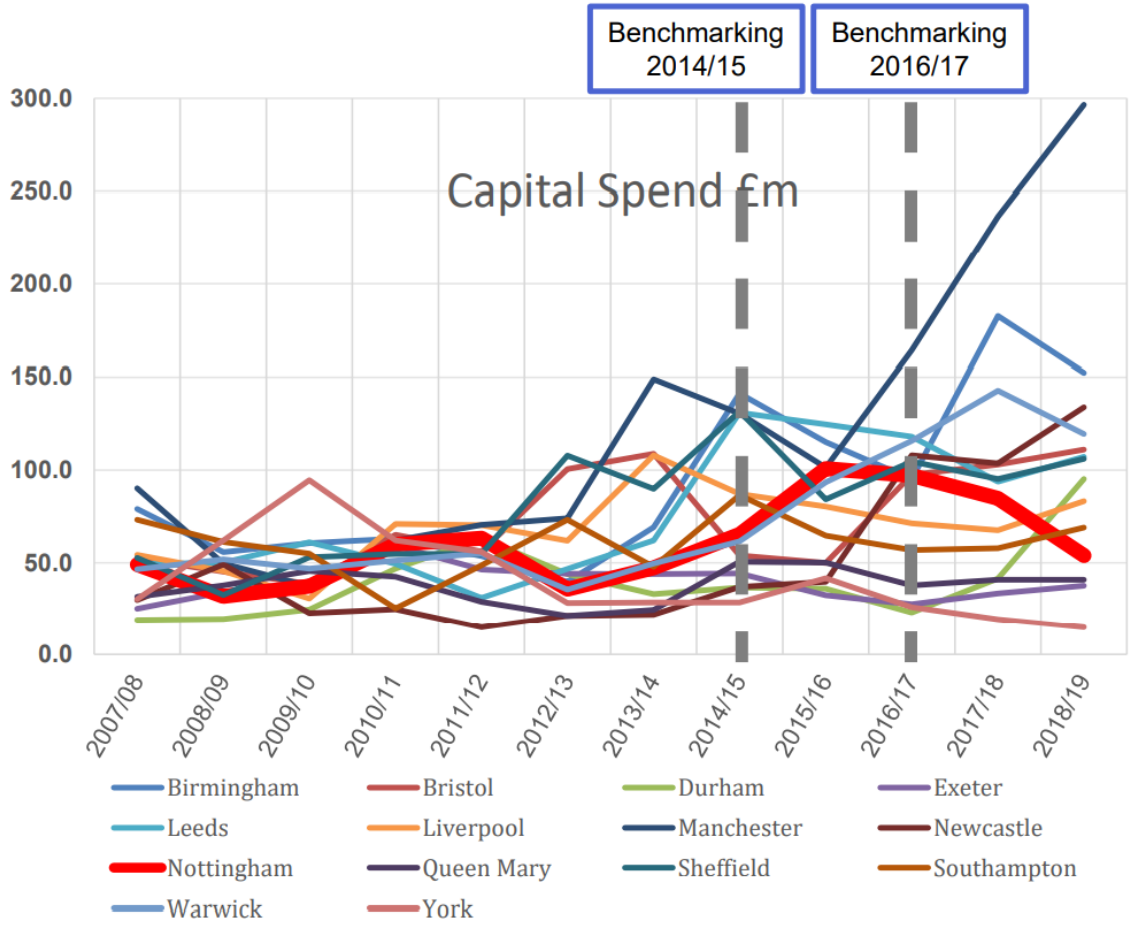
For context UoN is prioritising investment

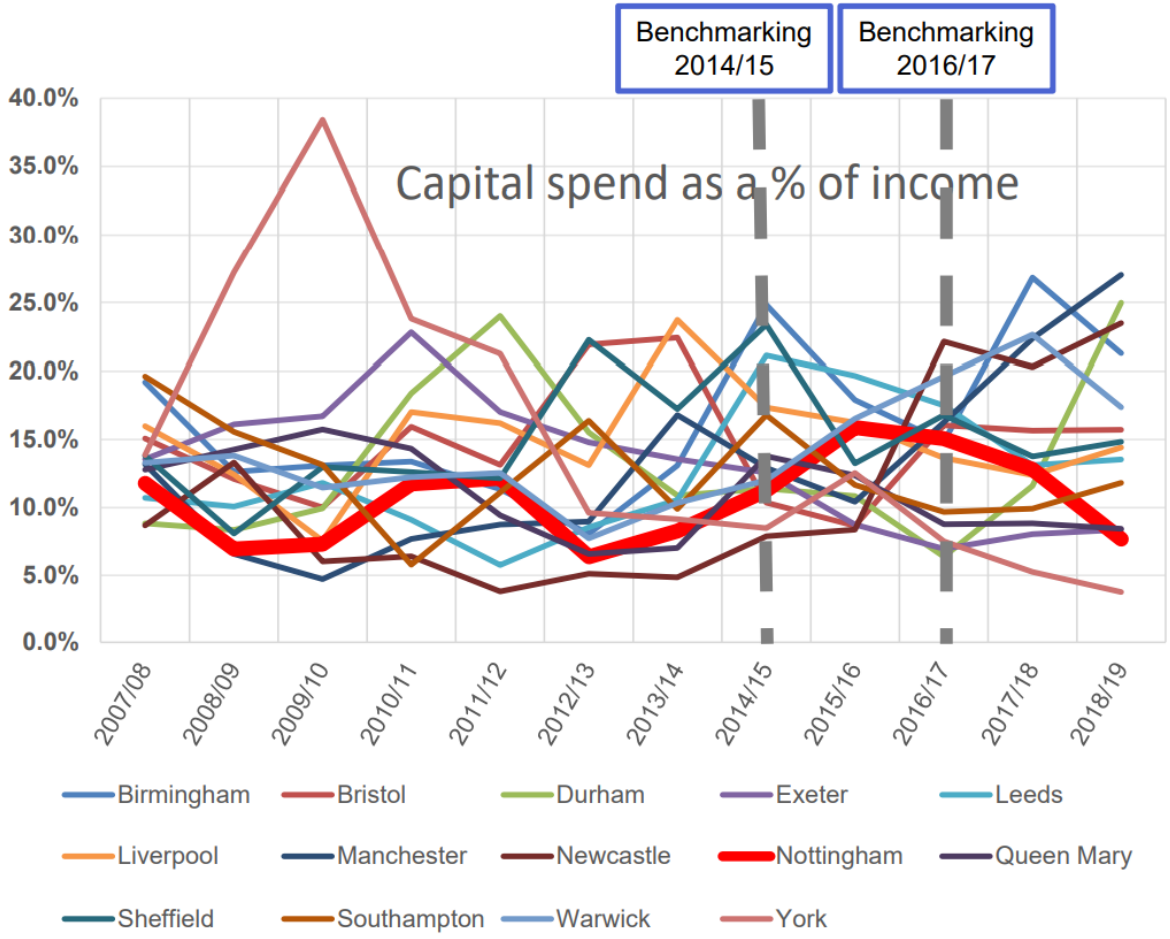
- All operating surpluses are invested back into the University
- We have priorities for investment which are decided through broad-based internal processes
- Our priorities include teaching and learning buildings, our student accommodation estate and improved systems because we care about the working environment and health and safety of our staff and students
- In recent years we have not over-invested in capital spend and are in need of a fresh investment cycle – our level of investment has been trending below average for the Russell Group

We want to invest in our future, within our means, in a fair and sustainable manner

Historic Capital Spend

The increase in capital spend between 2014/15 and 2016/17 coincides with the increase in debt incurred by Nottingham. Since 2016/17 capital spend has declined, reflecting a shift in investment type, from capital to revenue, via the Digital Futures programme and the Research Strategy.





Summary

To recap, overall summary of our response:

- our overarching priority is for sustainable financial management and investment for the future of our staff, students, teaching and research;
- counter to the ‘alternative strategy,’ the future of our University is not best served by increasing levels of debt, which would place additional burdens on future generations of students and staff;
- indeed, increasing debt only serves to increase annual interest payments which in turn would require greater not fewer financial efficiencies and restrict our ability to invest;
- as an institution, we are keen to invest in our future, but will do so within our means, rather than becoming reliant on increased financialisation and private lenders - trends that UCU itself has strongly objected to over the past decade;
- our day-to-day treasury model is based on cash management that reduces costs while maintaining liquidity, we have ample access to cash where required and believe that the UCU Branch has misunderstood this model;
- leading credit rating agency Standard & Poor’s performed an in-depth review of our financial arrangements last year and commented that “The University of Nottingham has improved its financial resources, putting it in a good place to weather COVID-19 related headwinds.”
- UEB sub-committees make most investment prioritisation recommendations and since 2018, these committees have included nominated members of staff from all job families. In 2020 we increased the number of such members on most committees. Council includes representatives from senate. Investments greater than £5m but less than £10m have to be approved by Finance Committee, and investments over £10m have to also be approved by Council – meaning there is a high level of scrutiny of any investment made by the University.