

## Enterprise M3 Board Meeting

1 October 2021

### Resources, Finance and Audit Committee Financial Update – Item 11

**The Enterprise M3 Board is asked to:**

**NOTE:** The current 2021/22 forecast and medium-term position (**Section 2**)

**NOTE:** The work taking place to address financial stability in the medium-term (**Section 3 and 4**)

#### 1. Executive Summary

- 1.1. This report provides a forecast for the 2021/22 revenue out-turn, and an updated 2021-2024 Medium Term Financial Plan, following activity to the end of August 2021. It also outlines the work taking place to ensure financial stability in the medium-term. This includes work being carried out to explore options for income generation, in order to develop a strategy and plan to expand our support to business, assist growth in our economy, and aid the LEP's future financial stability.
- 1.2. The EM3 Resources, Finance and Audit Committee (RFAC) met in September 2021 to review the position, and is satisfied that the LEP is appropriately considering the risks to its medium-term financial stability, and adequately planning to mitigate and address the potential implications of those risks.

#### **2021/22 Revenue Out-turn Forecast and Medium-Term Financial position (Section 2)**

- 1.3. The 2021/22 revenue budget was approved by the Board in January 2021. It is underpinned by our delivery/business plan, and is set to enable implementation and delivery of our developing Local Industrial Strategy and our Revive and Renew Plan. It supports activities to deliver our capital programme, business support activities and actions around skills such as the work of our careers and enterprise programme.
- 1.4. Since its approval, we have had further clarification of our funding streams, and have modified our planned activity in response. Significantly, we have received additional funding to continue our Peer-to-Peer programme, Growth Hub cluster activity, and Skills Action Plan activity. All of the additional income carries additional activity, and therefore costs, so that the overall impact is a small increase in forecast 2021/22 net income (+£47k)
- 1.5. We are keeping the Medium-Term Financial Plan (MTFP) under constant review. The Government is currently carrying out a review of LEPs, which will determine their future direction. Alongside this, there has been a shift in policy to entrust Local Authorities and Further Education establishments, with the responsibility to bid directly for Government capital allocations.
- 1.6. We continue to be in a good position for the next two years. We are able to carry out our plans in 2021/22 and 2022/23, as our reserves are at a sufficient level to cover activity. However, our ongoing planned expenditure exceeds our income by around £0.5m per year, and by the end of the three-year period (March 2024), our reserves are predicted to be £0.26m below the minimum level set by our reserves policy.

#### **Implications of potential reduced Government core operational funding (Section 3)**

- 1.7. In early 2021, Government confirmed it would provide LEPs with funding towards 2021/22 core operational activity. However, in July 2021, the Treasury took the decision to initially pay LEPs half of these funds and pause the rest, until a financial review is carried out, and the outcome of the LEP Review is known (expected by end of November 2021). LEPs have been asked to provide further financial information in order to inform Government's decision about funding for the second half of the year. Government will be considering the future funding of LEPs as part of the Spending Review and Levelling Up White Paper.

- 1.8. The LEP has been carrying out analysis to consider the potential implications on financial stability and future activity, considering a number of different Government funding scenarios. Unlike many other LEPs, we are in the fortunate position of being able to use surplus reserves, built up over the years from careful management of our resources, to cover expenditure to the end of March 2024.
- 1.9. In summary, with current assumptions, we are in a position where after March 2024, we would be required to make further savings or generate additional income totalling approximately £0.5m per year. However, our scenario planning demonstrates that, in the event of reductions to our core Government funding, our minimum reserves level would be breached much earlier. With reduced funding, we would be required to start making cost savings and generate additional income a year earlier, and at an increased level.
- 1.10. RFAC is satisfied that the LEP is adequately considering the risks, and acknowledged that more meaningful analysis will be required once Government announces its intentions for the future direction of LEPs. This is expected to follow the Comprehensive Spending Review which will be announced on 27 October 2021.

#### **Income Generation (Section 4)**

- 1.11. Faced with a trend of diminishing reserves, as well as the uncertainty of future Government funding, we continue to explore opportunities for income generation.
- 1.12. Over the last three months we have held internal workshop sessions to explore the potential for EM3 to draw in funds from and to provide revenue generating services to our local authority partners, university and college partners, and local businesses, in order to further develop the economy of the area.
- 1.13. The next stage is to work with our partners and Board members to develop some of these ideas. This will include exploratory discussions with partner organisations. We will examine the costs, risks and rewards, and assess the impact on capacity to ensure we retain the ability to deliver other priorities.

#### **Next Steps**

- 1.14. RFAC will continue to play a key role in overseeing the budget, managing risks and keeping the Board informed. We will update our forecasts and plans following the outcome of the Government's Review of LEPs and the Comprehensive Spending Review, alongside work with the Board exploring the future direction of the LEP.
- 1.15. Together with the development of our income generation plan, we will review the organisation to ensure it has the right resources to respond to new challenges. This may involve some up-front investment, which will be managed from our resources, but may require some fund deployment and budget variation.

## **2. Revised 2020/21 Budget and Medium-Term Financial position**

- 2.1. Table 1 shows our revised forecast reserves position against budget, following the first four month's activity of the year (April- July 2021), and our revised medium-term financial stability.

2020/21 ACTUAL £'000	Table1: EM3 Revenue Reserves	2021/22 Budget £m	2021/22 Forecast £m	2022/23 Estimate £m	2023/24 Estimate £m
2.8	<b>TOTAL RESERVES AT START OF YEAR</b>		<b>3.0</b>	<b>2.4</b>	<b>1.9</b>
3.4	<i>Income</i>	2.3	2.5	2.4	2.4
(3.2)	<i>Expenditure</i>	(2.9)	(3,111)	(2,880)	(2,914)
0.24	<b>Use of reserves</b>	<b>(0.66)</b>	<b>(0.62)</b>	<b>(0.50)</b>	<b>(0.48)</b>
3.0	<b>TOTAL RESERVES AT END OF YEAR (A)</b>		<b>2.4</b>	<b>1.9</b>	<b>1.5</b>
<b>TOTAL</b>					
1.7	Minimum Revenue Reserves Level (B)		1.9	1.7	1.7
1.4	<b>RESERVES AVAILABE FOR USE (C)</b>		<b>0.580</b>	<b>0.23</b>	<b>0.26</b>

- 2.2. Our **reserves policy** stipulates that our reserves should be maintained at a minimum level which covers 50% of annual operational expenditure. Table 1 (Row C) shows that we would be within the minimum reserves level at the end of this financial year, and the next, but would breach it by **£0.26m** at the end of 2023/24.
- 2.3. When the 2021/22 budget was set in January 2021, our reserves were predicted to stand at £1.2m by the end of the three-year MTFP period (March 2024). We now forecast reserves at the end of March 2024 to stand at **£1.5m** (Row A) i.e. £0.3m higher. This improvement is a result of:
- An additional 2020/21 surplus out-turn (+£0.1m), as reported to the Board in May 2021.
  - An improved 2021/22 forecast position (+£0.15m), mainly arising from additional income from Government to take on additional activity, requiring additional resources. This includes Peer-to-Peer network activity to support SMEs to recover from the impacts of COVID-19; Growth Hub funding to cover cluster activity; and capacity funding to develop our Local Skills Action Plan.
  - An improved 2022/23+ MTFP position, mainly due to an earlier than expected up-turn in Bank of England base interest rates (£0.05m).
- 2.4. Along with our general revenue balances, Enterprise M3 also holds a Capital to Revenue Fund, the unallocated balance currently standing at £0.7m. This may be used to further support revenue activity for the renewal and revival of our economy, and there may be scope to increase this balance with an additional transfer of our capital funds. The fund was established to predominantly support scheme development and design advancement, but has also been used towards skills and career improvement, scale-up business support, and to support COVID-19 business recovery activity. The underlying provision is that the funds should be used for one off revenue projects, and not to fund ongoing revenue activity.
- 2.5. As noted in our last report to the Board, we have assumed revenue funding and activity largely at the current level; and that there will be no further Government capital funds allocations. **Appendix 1** sets out the updated Key Financial Risks and Assumptions incorporated in our financial management. Mitigation against the risks is in place, and this continues to present a prudent, robust budget and MTFP.

### **3. The implications of potential reduced Government core operational funding**

- 3.1. Government provides LEPs with a funding contribution towards their annual operating activities. Each LEP is required to match fund this contribution locally. Since 2015/16 this core Government funding has been set at £500k, and the same level was initially confirmed for this financial year. However, at the end of July 2021, the Treasury announced that LEPs would initially receive £250k to cover the first six months of the year, and that the Government would use the LEP review process to collect further financial data on LEP performance, to inform decisions on funding for the remaining six months of the year. No decision has yet been made about funding of LEPs in future years.
- 3.2. In addition to the LEP core funding, Government provides similar funding for running our Growth Hub (GH). The basic level of funding of £537k has been confirmed for 2021/22. This funding is not expected to be curtailed this year.
- 3.3. With this uncertainty in the future level of Government funding, and as work continues on the review of LEPs, including consideration of their future direction, the LEP is prudently managing and reviewing its activity. This includes considering financial stability in various scenarios, putting us in a good position to plan for the future once Government announces its intentions for the future direction of LEPs.

### **4. Income Generation**

- 4.1. In the current environment of uncertainty and change, the way in which EM3 operates will need to evolve. Over the last few months, we have been working with RFAC and the Board, to explore options for income generation, in order to develop a strategy and plan to expand our support to business, to assist growth in our economy, and aid the LEP's future financial stability.

- 4.2. In May we reported to RFAC and the Board, summarising the work carried out during the discovery phase of our income generation study. We concluded that during the next stage we would explore specific areas in which we might develop and sell services to generate income. Over the last three months we have held internal workshop sessions to explore the potential for EM3 to sell further services to partner organisations.
- 4.3. Our first priority is to ensure we retain existing funding contributions from partners, and then look to generate further income by offering further support to our partners, with a focus on supporting businesses and enabling economic growth.
- 4.4. The next stage of the income generation work is to:
  - Hold exploratory discussions with local authority and education partners, other LEPs, cluster partners and other local businesses, to reinforce our continuing partnership role, and develop potential service offers.
  - Work with Board members and sub-groups to determine our future investment strategy and opportunities.
  - Assess impact on capacity, and ensure we retain the ability to deliver other priorities.
  - Examine the costs / risks and rewards of emerging delivery models.
  - If required, engage external research or consultancy support in a few specific areas.
- 4.5. We will need to consider carefully the impact on capacity of developing new initiatives, which must not detract from our ability to deliver core priorities. Collaboration with other LEPs on new ideas to help grow the economy, could help us to develop efficient approaches and address potential capacity issues.
- 4.6. We will continue to work with and seek guidance from RFAC and the Board, as our income generation plans develop, and the future direction of LEPs becomes clearer, to ensure we have the right resources to respond to new challenges. This may involve some up-front investment, which could be managed from within our overall resources, but might potentially require some internal redistribution of funding.

**Aleks Bennett**  
**EM3 Finance Manager**  
**23 September 2021**

The Board should be aware of the **key financial risks** associated with the medium term-financial plan. The plan has been prepared under prudent assumptions; however, key risks remain relating mainly to the uncertainty of Government funding and policy. ***Changes from previous report in bold italics***

<b>Appendix 1: Key Financial Risks and Assumptions</b>				
Risk	Description	Impact	Likelihood	Mitigation
<b>Government Capital Funding uncertainty</b>	<p>The current Government Capital Deal (Getting Building Fund) ends in 2021/22.</p> <p>Government has determined its policy to entrust Local Authorities with the responsibility to bid directly for allocations from the Levelling Up Fund, the UK Community Renewal Fund and the Community Ownership Fund, and for their subsequent delivery. Similarly Further Education capital funding will no longer go via the LEP.</p> <p>We are prudently assuming no further growth deals will be distributed through LEPs.</p>	<p><b>Low</b></p> <p>We are able to carry out our plans in 2021/22 and 2022/23, as our reserves' levels are at a sufficient level to cover activity.</p> <p>The need remains to secure further funding/income generation/cost-savings, in order to cover activity in 2023/34 and beyond.</p> <p>Should we successfully attain further capital funding, each £1m capital fund would yield around £40k revenue funds via application fees and interest.</p>	<b>Low</b>	<p>For 2021/22 and 2022/23 we have enough reserves to cover the potential gap in funding of £0.5m - £0.6m per year in our budget.</p> <p>We are working with RFAC to explore opportunities for further savings and additional income, to address the longer- term gap.</p>
<b>Government Revenue Funding uncertainty</b>	<p>Government has confirmed revenue funding contributions for the LEP operational and Growth Hub activity, at the same level as 2020/21 (LEP £500k, and Growth Hub £617k, including £80k for cluster activity).</p> <p>Assumptions for the 2022/23+ medium-term plan are that funding continues at same level excluding cluster activity (£537k).</p> <p><b><i>However, in July 2021, the Treasury took the decision to pay LEPs for half the £500k funds due in 2021/22 and pause the rest until the outcome of the LEP Review is known (expected by end of November 2021).</i></b></p>	<p><b>Medium</b></p> <p>Without this continued funding, we would not be able to maintain same level of activity to cover the two years activity post 2021/22 to the end of 2023/24.</p> <p>We would need to reduce costs/activity or secure further funding/cost-savings of £2m.</p>	<b>High</b>	<p>We are working with RFAC to:</p> <ul style="list-style-type: none"> <li>• Identify implications of reduced core funding</li> <li>• Explore opportunities for further savings and additional income, to address the longer- term gap.</li> </ul>

Appendix 1: Key Financial Risks and Assumptions				
Risk	Description	Impact	Likelihood	Mitigation
<b>Partner Contributions</b>	<p>The budget and medium-term forecast included the assumption we will continue to receive significant contributions of £403k per year in total, from Local Authorities (LAs - £320k), Universities (HEs - £53k) and Further Education Colleges (FEs - £30k) to help fund our support, in particular providing funding for them to deliver capital projects.</p> <p><b><i>The revised forecast has removed HEs - £53k for the current year.</i></b></p> <p>As Government has no medium-term plans to use LEPs to manage and distribute large capital funds, and the strategic direction of LEPs is being reviewed, these establishments may no longer wish to support our activities in the same way.</p>	<p><b>Medium</b></p> <p>Removal of LA, HE and FE funding would see a reduction in income of £0.4m per year.</p>	<b>Medium</b>	<p>For 2021/22 and 2022/23 we have enough reserves to cover the potential gap in funding of £0.4m per year in our budget.</p> <p>The Joint Leaders Board were notified of the 2021/22 LA contribution, and as we are continuing to deliver a significant part of our current programme in 2021/22, this risk is low in 2021/22, and rises in the subsequent years.</p> <p>We are working with RFAC to explore opportunities for further savings and additional income, to address the longer- term gap. The results of the Government's review of LEPs (expected by November 2021), and our work with the EM3 Board and other stakeholders, will shape the future direction of the LEP. This will involve discussions with our partners to determine the support we can provide, and the corresponding income.</p>
<b>Future Direction of LEPs</b>	<p>With the shift in Government policy away from having LEPs manage and distribute large capital funds, and their current review of LEPs, the future direction of LEPs is currently uncertain. The budget assumes revenue funding and activity largely at the current level; and that there will be no further Government capital funds allocations to LEPs.</p>	<p><b>Medium</b></p> <p><b>2021/22:</b> Moderate. Current year Government revenue <b><i>of £250k is confirmed, and the remaining £250k is under review.</i></b> Capital programme will require similar level of LEP activity. <b><i>We may require additional funding to £250k</i></b></p> <p><b>2022/23+</b> Significant: Without continued Government funding at the core levels currently received, we would not be able to maintain same level of activity to cover the two years activity post 2021/22.</p> <p>We would need to reduce costs/ revise activity or secure further funding/cost-savings of £2m.</p>	<b>High</b>	<p>Our medium-term financial plans are prudently based on assumptions that we will receive no further Government capital funding, thus our capital programme is much reduced. Activities and staffing are assumed to continue at the current levels.</p> <p>We have enough reserves to cover the potential gap in funding to the end of 2022/23</p> <p>We will update our forecasts and plans following the outcome of the Government's Review of LEPs (expected by end of November 2021), alongside the work with the Board exploring the future direction of the LEP.</p>

Appendix 1: Key Financial Risks and Assumptions				
Risk	Description	Impact	Likelihood	Mitigation
<b>Interest Rate uncertainty</b>	We receive interest on our balances held by HCC, as our accountable body, at the Bank of England base rate. Our forecasting assumes that rates will remain at 0.1%, <b><i>and recover to 0.25% in the following two years. This is in accordance with global macro models and analysts' expectations, the base rate is projected to trend around 0.1% percent levels of during 2021 and recover to 0.25% percent in the first part of 2022.</i></b>	<b>Low</b> Due to the low level of capital funding assumed, a change in the level will not impact reserves significantly. For example, if interest rates did not recover from 0.1%, the overall effect over three years is £38k. Similarly, if the base rate fell to below zero, say -0.1%, and in the unlikely event it remained there during the medium term, the effect on income is approximately £115k.	<b>Low</b>	We have enough reserves to cover the potential gap in funding in 2021/22 and 2022/23. We are working with RFAC to explore opportunities for further savings and additional income, to address the longer- term gap.
<b>Interest receivable on loans</b>	The budget and medium-term forecast includes interest receivable on three loans issued from our capital funds. Two of these were formally deferred in 2020/21, due to COVID 19 related business disruption. There is a risk that further deferment is necessary.	<b>Medium</b> Further deferment would see a reduction in income as follows: 2021/22: £110k 2022/23: £346k 2023/24: £400k We have enough reserves to cover the potential gap in funding in 2021/22, however our reserves would fall to £153k below minimum level by the end of 2022/23.	<b>Low</b>	We are in regular contact with the loan holders. We have enough reserves to cover the potential gap in funding in 2021/22. We are working with RFAC to explore opportunities for further savings and additional income, to address the longer- term gap.