Enterprise M3 Board Meeting

6 October 2022

Item 10 – Resources, Finance and Audit Committee Financial Update

The Enterprise M3 Board is asked to:

NOTE: The current 2022/23 forecast and medium-term position **(Section 2)**

NOTE: The implications of the changes arising from the review of the organisation **(Section 3)**

NOTE: The key financial risks associated with the 2022/23 Revenue Forecast, and the 2022-2025 Medium Term Financial Plan **(Appendix 1)**

1 Executive Summary

1.1 This report provides a forecast for the 2022/23 year, and an updated 2022-2025 Medium Term Financial Plan (MTFP), based on the budget approved by the Board in May 2022.

1.2 The EM3 Resources, Finance and Audit Committee (RFAC) met in September 2022 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.

1.3 We have now completed the review of our organisation and delivery methods, to ensure they are fit for purpose, and provide financial stability in the medium term. This will enable us to deliver objectives, whilst ensuring that efficiencies are not made at the detriment of maintaining sufficient capacity. The formal period of staff consultation relating to the proposed changes ended on 18th September 2022, and we are now in a position to implement the proposals. The figures in this report take into account the effect of implementing those proposals.

1.4 The revised forecast and plan also incorporate updated assumptions. These include those affecting inflation and interest rates; and assumptions that our partners and Government continue to fund us at the current funding levels. Any reduction would require us to rationalise our activity or secure further income.
The key financial risks associated with the forecast are set out in **Appendix 1**.

<u>2022/23 Final Revenue Forecast and the 2022-2025 Medium Term Financial Plan (Section 2 & 3)</u>

1.5 In May 2022, the Board approved the Revenue Budget for 2022/23, and the 2022-2025 MTFP. In order to remain financially stable throughout the medium-term, the 22/23 budget incorporated a savings target of £0.15m, and a cumulative savings/income generation target of £0.6m by the end of March 2025.

1.6 Integrating the outcome from our organisational review, and revised economic assumptions, we are on track to exceed both targets, improving our reserves position at the end of March 2025 by **£0.2m**. This provides mitigation against future risks, and some flexibility to expand our activities.

1.7 In summary, our financial plan forecasts that we will remain financially stable in the medium term, with the right resources and processes in place to deliver our vision most effectively.

<u>Next Steps</u>

1.8 We will implement the outcome from our organisational review over the next few months. This includes recruitment to a number of posts, providing capacity to deliver our future vision.

1.9 RFAC will continue to play a key role in overseeing the budget, exploring opportunities for savings and income generation, managing risks and keeping the Board informed.

1.10 We remain committed to continue exploring further opportunities for savings and income generation, allowing us to bring in the required expertise to grow and position the organisation for its evolving role.

2 2022/23 Final Budget and Medium-Term Financial Plan

2.1 Our 2022/23 budget and MTFP is set to provide resources to allow the LEP to deliver our new vision. The budget is underpinned by our delivery plan, and is set to drive forward low-carbon high-growth in our economy. As an integrated Growth Hub/LEP service, we will accomplish this together with our partners and stakeholders. We will also continue to develop and deliver our ongoing capital programme, careers activity and Enterprise Zone.

2.2 **Appendix 1** sets out the key financial risks and assumptions integrated in our financial management. The key assumptions are as follows:

- Inflation will average 10% over the medium term. Salary inflation will average 5% in 22/23, and will increase to 9% in the medium term. This is in-line with current economic commentary
- The Bank of England base interest rate will average 1.75% in 2022/23 and 3% in the medium-term. This is in line with current econometric models.
- Funding from our partners and Government will remain at the current level.

Mitigation against the risks means that we continue to present a prudent, robust budget and MTFP.

2.3 **Table 1** below summarises our current 2022/23 forecast against budget following the first four month's activity of the year (April- July 2022); and the updated medium-term financial stability position up to 31 March 2025.

2021/22 Actual £m	TABLE 1: EM3 Revenue Reserves	2022/23 Budget £m	2022/23 Forecast £m	2023/24 Estimate £m	2024/25 Estimate £m	
3.0	**TOTAL RESERVES AT START OF YEAR**		**2.6**	**2.5**	**2.2**	
2.4	*Income*	*2.3*	*2.5*	*2.4*	*2.1*	
(2.8)	*Expenditure*	*(2.5)*	*(2.6)*	*(2.7)*	*(2.9)*	**TOTAL**
(0.41)	**Use of reserves**	**(0.23)**	**(0.17)**	**(0.28)**	**(0.79)**	**(1.24)**
2.6	**TOTAL RESERVES AT END OF YEAR (A)**		**2.5**	**2.2**	**1.4**	

1.7	Minimum Revenue Reserves Level (B)		1.2	1.2	1.3
0.92	**RESERVES AVAILABE FOR USE (C)**		**1.27**	**0.96**	**0.09**

2.4 **Table 1** summarises our medium-term financial stability position up to 31 March 2025. Our reserves are predicted to stand at £1.4m (row A) by the end of the three-year MTFP period (March 2025). This is an improvement of £0.2m on the position expected when we set our 2022/23 budget in May 2022.

2.5 The forecast maintains the minimum reserves level stipulated in our reserves policy (rows B and C). The policy stipulates that reserves should be maintained at a minimum level which covers four months of annual operational expenditure (approximately £0.9m), plus staff redundancy costs (approximately £0.3m).

2.6 The budget incorporated a savings target of £150k, with a further £220k per annum for the next two years, totalling just under £0.6m to the end of March 2025. We have now identified those savings, and the table demonstrates that we expect to remain financially stable for the three-year term.

2.7 The savings target is achieved mainly through the changes developed through our organisational review. We expect to achieve a net saving of **£0.9m** over three years. This involves removing some posts from the existing structure, and adding new posts and additional capacity via contracting and other means, which will provide us with the skills and capacity to delivery our vision and objectives. **Section 3** explains further.

2.8 The forecast incorporates revised assumptions, which reduce the surplus by £0.1m, providing an overall improvement of the three-year position by £0.2m. The revised assumptions include the negative impact of the anticipated rise in inflation, including salary inflation; and the positive impact of rising interest rates, which affects the interest we receive on our capital and revenue bank balances.

2.9 With the assumptions and changes set out, we are now in a good position to deliver our vision until the end of our medium-term financial plan. Reserves will remain above the minimum level. We are able to achieve this as we are in the fortunate position of being able to use the **£1.24m** of surplus reserves, built up over the years from careful management of our resources.

3 Organisational Review

Summary

3.1 Over the last two years, the LEP landscape has changed significantly. Following their national review of LEPs, Government provided a mandate for LEPs within the Levelling Up white paper which set out the expectations on the responsibilities of LEPs and the direction of travel regarding county deals and integration into local authorities.

3.2 Since the start of 2021, EM3 has been working with the Board, partners and wider stakeholders to understand the key strengths and value of the LEP. This exercise helped shape the extensive work to develop the focus, direction, and shape of the future LEP.

3.3 In addition, Government reduced their funding of LEPs - in 2022/23 resulting in a 25% reduction in LEP core funding, and a 50% reduction in funding for the Growth Hub. This, together with the targeted use of our retained reserves effected in the last few years, resulted in the need to make savings or generate additional income in order to remain financially sustainable over the next three years. Thus, the budget approved by the Board in May 2022 presented a financially sustainable medium-term plan, which incorporated a savings target of £150k in 2022/23, and a further £220k per annum for the next two years.

3.4 In March 2022, the Board endorsed EM3's new vision and focus. This set the basis for developing the structure based on the capabilities needed to deliver the vision, which would incorporate making efficiencies, whilst ensuring sufficient capacity and expertise is maintained.

3.5 In developing the new structure, we engaged an independent consultant to carry out a review of the organisation, covering support to business; skills and careers; and support services. The review looked at the current activities, and the capability required to deliver the new vision and areas of focus. It compared practice with other LEP operations, and included interviews with staff.

3.6 The output of the review provided data needed to establish the capabilities required in the new LEP, and how they can be given effect. The Joint Managing Directors reviewed the outputs and proposed roles, working closely with the accountable body's HR team.

3.7 Hampshire County Council accommodates redundancy under both compulsory and enhanced voluntary terms. Having reviewed the options, costs and implications of each, redundancy on compulsory terms was deemed the most appropriate option for the restructure. Redundancy costs arising from the restructure are not yet known, since those staff at risk of redundancy are able to apply for vacancies in the new structure. However, our reserves include a staff redundancy reserve which can cover the maximum potential redundancy costs, while still leaving enough funds in the staff redundancy reserve to cover any future compulsory redundancies for remaining staff.

3.8 Following a formal period of consultation with staff, in relation to the proposed changes within EM3, we are now in a position to implement the changes. Incorporating the new structure with supporting capacity, would mean that we would exceed our three-year savings target of £0.6m, as demonstrated in section 2 - therefore remaining financially stable to the end of 2024/25, with some mitigation against future risks, and flexibility to expand our activities.

Proposed Revised Structure and Financial Implications

3.9 The rationale for and key benefits of the agreed changes are:

- To deliver the new strategic vision for the LEP. The change in focus requires some variation in type of resource, or activity to be delivered in a different way.
- To achieve the savings required, following the reduction in Government funding and our planned used of surplus reserves.
- To respond to a significantly reduced capital programme – there will be no further growth deal funding to the LEP, however we will continue to manage our legacy capital programme and the new Future Fund programme. The reduced volume of new projects, contracts, claims, administration, and associated governance therefore leads to a reduction in resources required to manage and maintain these programmes.
- To provide a sustainable future by enhancing the LEP's commercial capability –the priorities of the new EM3 vision require the LEP to be more commercial, to commercialise the operations of the LEP where possible and appropriate, and to work with partners to leverage private investment and funding to the region.
- To bring together delivery programmes to increase effectiveness – skills supply is a key issue faced by employers, and closer liaison between the Growth Hub and skills/careers activity can be improved if it is reflected in the organisation's structure.
- To work more collaboratively across the team for greater delivery impact and to identify opportunities - bringing together all performance monitoring, analysis and reporting should lead to increased consistency, better use of resources, enhanced communications of the LEP's impact and identification of opportunities to join up.
- To remain agile – not all capabilities required are being proposed within the permanent structure. Some can be delivered via contracts, through consultancy or other arrangements. We have incorporated increased budgets for additional capabilities, including marketing, economic and business analysis, and policy expertise, for example clean growth/net zero.

4 Ongoing monitoring

4.1 RFAC will continue to play a key role in overseeing the budget, managing risks, and keeping the Board informed. This includes monitoring 2022/23 income and expenditure and the medium-term-financial forecast, on an ongoing basis, adjusting the forecast accordingly, challenging spend and championing future sustainability through increased income and expenditure savings.

Aleks Bennett - EM3 Finance Manager

27 September 2022

Key Financial Risks and Assumptions **Appendix 1**

The Board should be aware of the **key financial risks and assumptions** associated with the medium term-financial plan. The budget and medium-term forecast has been prepared under prudent assumptions.

Appendix 1: Key Financial Risks and Assumptions

Risk	Description	Impact	Likelihood	Mitigation
Government Revenue Funding uncertainty	In 2022/23 Government provided £375k for LEP core funding, and £268k for Growth hub funding. In addition, there is a further £55k for skills action plan and £40k for GH cluster work. Assumptions for the 2023/24+ medium-term plan are that funding continues at same level as in 2022/23 WITHOUT £55k skills action plan funding. Total £683k per year	**High** No risk in 2022/23. If the funding is not provided in 2023/24 and 2024/25, we would need to reduce costs/activity or secure further funding/cost-savings of approximately £683k per year.	**Medium**	We are working with RFAC to explore opportunities for further savings and additional income, to address further gaps in the longer term. We have agreed our future vision, following clarification from Government about the future funding and direction of LEPs. We are carrying out an organisational review. Draft proposals ensure we are able to deliver our future vision, within a budget which ensures the minimum reserves level is maintained over the next three years.
Partner Contributions	The budget and medium-term forecast include the assumption that we will continue to receive significant contributions of £350k per year in total, from Local Authorities (LAs - £320k), and Further Education Colleges (FEs - £30k) to help fund our support, in particular providing funding for them to deliver capital projects. Matched funding is required to draw down funds from government. Given the pressures on LA and FE funding and reductions in capital funding partners may look to reduce their level of match in the future.	**High** Low risk in 2022/23. The majority of LAs have provided their contributions. In addition, some higher education establishments have offered £10k contribution each for the year. Removal of partner funding in future would see a reduction in income of £350k per year. More importantly it would not allow us to draw down funding from government. Should matched funding be reduced we would need to reduce costs/activity or secure further funding/cost-savings of approximately £350k per year	**Medium**	We are working with our LAs to ensure they continue to match our funds. We are working with RFAC to identify opportunities for additional income, to address any potential future gap. This is involving discussions with our partners, including HE, to determine the support we can provide, and the corresponding income. We have agreed our future vision, following clarification from Government about the future funding and direction of LEPs. We are carrying out an organisational review. Draft proposals ensure we are able to deliver our future vision, within a budget which ensures the minimum reserves level is maintained over the next three years.

Key Financial Risks **Appendix 1 continued**

Appendix 1: Key Financial Risks and Assumptions				
Risk	**Description**	**Impact**	**Likelihood**	**Mitigation**
Financial Viability	To remain financially stable in the medium term, we must make savings or identify income generating opportunities, totalling £0.6m by the end of March 2025.	**Medium** We will cease being financially viable during 2024/25, if we do not identify and implement savings/additional income opportunities of £0.6m before the end of that year	**Medium**	We have identified achievable savings targets for the next three years, which ensure we have enough reserves to cover the gap in funding to the end of the medium-term period (2024/25). We continue to work with RFAC to explore opportunities for further savings and additional income, in order to ensure we have sufficient resources to cushion any future reduction in income, and to enable us to position and grow into our new role.
Interest Rate uncertainty	We receive interest on our balances held by HCC, as our accountable body, at the Bank of England base rate. Our forecasting now assumes that rates will average 1.75% in 22/23, then 3% to the end of the medium-term plan. This is a conservative estimate based on the latest global macro models and analysts' expectations.	**Low** Due to the low level of capital funding assumed, a change in the level will not impact reserves significantly. For example, in the unlikely event that interest rates did not increase from the current 2.25%, the overall effect is under £60k per annum.	**Low**	We have enough reserves to cover the potential gap in funding to the end of 2024/25 We are working with RFAC to explore opportunities for further savings and additional income, to address any further gaps in the medium term.
Inflation	Inflation has risen considerably in the last few months, with predictions that the rate will remain at 10%+ in the medium term. We have revised the assumptions in place when the budget was approved, General inflation is set at 10%. Salary inflation will average 5% in 22/23, in line with current union negotiations, rising to 9% in the medium term.	**Low** Salary inflation could increase by a further 3% in the next two years, and we would remain financially stable to the end of the MTFP. Anything higher would mean that we would need to make further costs-savings/generate-income in 2024/25. However, inflation would need to rise to above 30% from 2023/24, for us to be in a financially compromised position before the final year of our medium-term financial plan.	**Medium**	We have enough reserves to cover the potential gap in funding to the end of 2024/25 We are working with RFAC to explore opportunities for further savings and additional income, to address any further gaps in the medium term.