enterprise M3

Delivering prosperity through innovation

Enterprise M3 Board meeting

2 February 2023

ITEM 9: Resources, Finance and Audit Committee Update

2023/24 Outline Revenue Budget and Medium-Term Financial Stability

The Enterprise M3 Board is asked to:

ENDORSE the Outline Revenue Budget for the 2023/24 financial year, subject to a final budget being brought to the Board, once details about the funding of LEPs emerge. **(Section 3)**

NOTE: The 2023-2026 Medium Term Financial Plan **(Section 3)**

NOTE: The forecast 2022/23 outturn position at the end of December 2022 (Quarter 3) **(Section 2)**

NOTE: The key financial risks associated with the 2023/24 Revenue Budget, and the 2023-2026 Medium Term Financial Plan **(Appendix 1)**

1. Executive Summary

1.1. This paper sets out the **Outline** Revenue Budget for 2023/24, and 2023-2026 Medium Term Financial Plan (MTFP), and also provides an updated forecast for the 2022/23 out-turn position at the Quarter 3 position (April-December 2022).

1.2. The Enterprise M3 (EM3) revenue budget is set to enable delivery of EM3's vision for a low-carbon, high growth economy, including supporting activities to deliver our sector, innovation and trade work to support business and actions around skills and net zero. This incorporates delivering our future fund capital programme, and our contractual commitments relating to delivery of growth hub services, skills and careers and enterprise activities. The budget is underpinned by our delivery/business plan.

1.3. The purpose of this report is to seek the Board's endorsement of the 2023/24 outline Revenue Budget, and sets out our 2023-2026 Medium Term Financial Plan (MTFP). Once details emerge about Government's 2023/24 funding of LEPs, we will bring a **final** Revenue Budget for 2023/24 for approval. With current anticipated timings, we expect this to be in April 2023.

1.4. On 19th January 2022, the Resources, Finance and Audit Committee (RFAC) reviewed the proposed 2023/24 outline budget, and agreed to recommend the Board endorse it.

1.5. The paper also provides an updated forecast for the 2022/23 out-turn position at the Quarter 3 position (April-December 2022).

Rationale and current position:

1.6. Government has not yet announced LEP funding for 2023/24, although is expected to do so soon. In the meantime, to plan delivery of our objectives from 1 April 2023, we must agree an operating budget. Therefore, we are initially asking the Board to endorse an outline Revenue Budget for 2023/24. Once funding is announced, we will bring a final 2023/24 Revenue Budget for approval. With current anticipated timings, we expect to bring this to the next RFAC meeting, in March 2023, to be approved by Board in April 2023.

1.7. We are nevertheless in a position to agree an outline three-year financial plan which ensures **financial stability** in the medium term. This follows review of our organisation and delivery methods, to ensure they are fit for purpose, and ongoing implementation of resulting outputs.

1.8. The key financial risks associated with the outline budget and MTFP are set out in **Appendix 1**. Significantly:

- We are currently assuming that our partners (local authorities, colleges, and universities) and Government continue to fund us at the current funding level.
- We have incorporated future pay award assumptions at 5% to the end of 2025/26. This is prudently above the currently anticipated public sector salary inflation rate, but below currently projected general labour market inflation rates.
- We assume that the Bank of England base interest rates will average 4% during 2023/24, and then fall back slightly during the remainder of the medium term. This is in line with current econometric models.

2023/24 Outline Revenue Budget and Medium-Term Financial Plan (Section 3):

1.9. With the assumptions set out, we are in a good position into the medium term. We are forecasting a reserves position, at the end of March 2026, of **£0.45m** above our minimum reserves level threshold. This provides mitigation against future risks, and some flexibility to expand our activities. We are able to achieve this as we are in the fortunate position of being able to use surplus reserves, built up over the years from careful management of our resources.

1.10. To provide further assurance that the outline budget is feasible, we have carried out scenario planning, considering funding implications, and other economic variables, on our financial stability and future activity. Should Government/partner funding or other income significantly reduce, we would nevertheless remain in a position where our reserves are at a sufficient level to cover activity in 2023/24 proposed in this budget; and in most cases, further activity into the 2025/26 financial year.

2022/23 Forecast Out-turn (Section 2)

1.11. In May 2022, the Board approved the Revenue Budget for 2022/23, incorporating a savings target of £0.15m. The position following activity to the end of Quarter 3 of the financial year, shows that we are on track to exceed the target, with an overall increase in forecast net income of **+£0.47m**. This is primarily due to receiving greater interest than anticipated when our budget was set.

Next Steps

1.12. We will continue to implement the outcome from our organisational review over the next few months, providing capacity to deliver our future vision and meet the expectations set by government. We have already recruited to a number of posts, including full recruitment to our management team; and are now recruiting to the remaining posts.

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

1.14. We remain committed to continue exploring further opportunities for savings and income generation, allowing us to bring in the required expertise to grow and respond to existing and new challenges faced by our economy, and position the organisation into its new role.

2. 2022/23 Forecast Out-turn

2.1. **Table 1** below summarises our updated 2022/23 forecast against the budget approved by the Board in May 2022. The position follows activity to the end of Quarter 3 of the financial year and revision of economic assumptions:

TABLE 1: EM3 Operating Income and Expenditure	2022/23		
	Approved Budget £m A	Quarter 3 Forecast £m B	Budget variance* £m C
REVENUE RESERVES Brought Forward		**2.6**	
Operating Income	*2.3*	*2.6*	*0.3*
Operating Expenditure	*(2.5)*	*(2.4)*	*(0.1)*
Addition to/ (Use of) reserves	**(0.23)**	**0.24**	**0.47**
TOTAL REVENUE RESERVES		**2.8**	

* Variance is positive when 2022/23 income is higher / expenditure is lower, than budgeted.

2.2 As summarised in **Table 1 *(column B)*,** in 2021/22 we anticipate income of **£2.6m** (budget £2.3m) will exceed in year expenditure of **£2.4m** (budget £2.5m), and we therefore expect to add **£0.24m** to retained reserves. This is an overall improvement of **£0.47m *(column C)***, on the budgeted draw on reserves of **£0.23m *(column A)***.

2.2. The improvement of **£0.47m** is mainly due to the increase in the Bank of England base interest rate, which affects the interest we receive on our capital and revenue bank balances. Additionally, we have reviewed our current and future capital programme, taking into account profiling of future income and expenditure.

2.3. In addition, there were further savings arising from our organisational review; additional income from our Higher Education partners who agreed to contribute towards our operational costs; and reduced running costs reflecting the continuing impact of the pandemic on ways of working, and in-person events. Partially set against this, was the higher than budgeted rise in inflation, including salary inflation.

3. 2023/24 Outline Revenue Budget and Medium-Term Financial Plan

3.1. Our focus in 2023/24 will be to drive forward delivery of EM3's vision for a low-carbon, high growth economy, including supporting activities to deliver our sector, innovation and trade work to support business and actions around skills and net zero. 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.

3.2. Our reserves policy stipulates that total reserves should be maintained at a minimum level which covers four months of annual ongoing operational expenditure (approx. £0.9m) **plus** staff redundancy costs (approx. £0.2m). This is in line with best practice and is approved by our accountable body.

3.3. **Appendix 1** sets out the key financial risks and assumptions integrated in our financial management. Mitigation against the risks means that we continue to present a prudent, robust budget and MTFP.

3.4. **Table 2** summarises our 2023/24 Revenue Budget and Medium-Term Financial Plan to the end of 2025/26:

2022/23 FORECAST* £m A	TABLE 2: EM3 three-year revenue forecast	2023/24 BUDGET £m B	2024/25 ESTIMATE £m C	2025/26 ESTIMATE £m D	
2.6	**TOTAL RESERVES AT START OF YEAR**	**2.8**	**2.9**	**2.3**	
2.6	*Income*	*2.9*	*2.4*	*2.5*	
(2.4)	*Expenditure*	*(2.8)*	*(3.0)*	*(3.2)*	**TOTAL**
0.24	**Addition to/ (Use of) reserves (E)**	**0.1**	**(0.6)**	**(0.7)**	**(1.2)**
2.8	**TOTAL RESERVES AT END OF YEAR (F)**	**2.9**	**2.3**	**1.7**	
1.1	Minimum Revenue Reserves Level (G)	1.1	1.2	1.2	
1.7	**RESERVES AVAILABLE FOR USE (H)**	**1.8**	**1.2**	**0.5**	

*Table 1 column B

2024/25 Revenue Budget

3.5. As summarised in **Table 2 *(column B)*,** in 2023/24 we anticipate a near break-even position. We expect that operating income of **£2.9m** (2022/23 £2.6m) will exceed in year operating expenditure of **£2.8m** (2022/23 £2.4m), adding **£0.1m** *(row E)* to retained reserves.

3.6. **Income:** Overall income in 2023/24, of £2.9m, is expected to be £0.3m higher in total than the previous year; the key points being:

- Interest receivable both from loans and on balances is expected to increase in line with rising average interest rates.
- Now that our careers activity is delivered through our Careers Hub, the funding body, the Careers and Enterprise Company, will support 100% of our careers strategic and operational lead activity, including related events and sponsorships.

3.7. **Expenditure:** Overall expenditure in 2023/24, of £2.8m, is expected to be £0.5m higher in total than the previous year; the key points being:

- There will be an increase in staff costs across our EM3 services, following a period in which we deliberately held a number of vacancies whilst we reviewed our structure.
- With our organisation fully staffed, we will be in a position to ramp up research and studies activity to support our businesses. This will include economic, skills and labour market analysis, as well as targeted support relating to jet zero, clean growth, creative tech, rural economy and other areas.
- General running costs are expected to increase. Primarily relating to an increase in stakeholder events, including those run by our Careers Hub, which will be fully funded by the Careers and Enterprise company. We also plan to increase our EZ³ programme activity, and our marketing campaign for the Growth Hub to increase activity to reach more businesses, to facilitate higher growth in the area.

The Medium-Term Financial Plan and Financial Stability

3.8. With the assumptions set out, we are now in a good position to deliver our vision until the end of our medium-term financial plan. Reserves will end at **£1.7m** *(row F)*, remaining above the minimum level by **£0.5m** *(row H)*.

3.9. We are able to achieve this as we are in the fortunate position of being able to use **£1.2m** of surplus reserves, built up over the years due to:

- careful management of our resources, including carrying out and implementing our organisational review, which ensures the LEP is able to deliver its priorities, whilst remaining financially sustainable; and
- significantly, an anticipated increase in interest receivable.

3.10. In a change from recent years, interest receivable now forms the most significant funding source, representing over 32% (£2.5m) of total income over the next three years, compared with 16% (£1.4m) in the last three years. We receive interest at the Bank of England base rate, on our balances held by our accountable body. The increase is partially due to the recent increase in interest rates; but it is also due to the interest receivable from developing our Future Fund capital programme. As we work with our partners to support low-carbon high-growth projects, though a revolving funding programme, we project a steady interest income stream, both from balances held and future loan interest.

3.11. Conversely, the proportion of income from Government sources (including Growth Hub funding and one-off funding), is anticipated to be significantly lower, at 27% of total income (£2.1m) in the next three years, compared with 44% (£3.6m) over the last three.

Sensitivity Analysis - 2023/24 to 2025/26 Medium-Term Financial Plan

3.12. Our MTFP is based on a number of **Key Financial Risks and Assumptions**, set out in **Appendix 1**. The highest risks are around future funding of the LEP, both from Government and our partners, and the impact of interest and inflation rates. In order to provide assurance to RFAC and the Board that our 2023/24 outline budget is robust and achievable, we have challenged the assumptions.

3.13. Our analysis demonstrated that the proposed 2023/24 outline budget could tolerate a reduction in funding from Government and our partners, as well as harsher economic assumptions. Even in the case of a 100% reduction in central Government and local partner funding, we could deliver our 2023/24 plans without breaching the minimum reserves level. However, in a position of significantly reduced funding, we would follow a more prudent course of action by implementing opportunities for savings and income generation as soon as possible.

3.14. Nevertheless, the analysis will provide the Board with comfort that, even with severe funding cuts, the proposed 2023/24 outline budget is financially viable.

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 2023/24 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 Head of Finance

26 January 2023

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 outline budget and medium-term forecast have been prepared under prudent assumptions.

Appendix 1: Key Financial Risks and Assumptions				
Risk	**Description**	**Impact**	**Likelihood**	**Mitigation**
Government Revenue Funding uncertainty	Government has not yet announced funding for 2023/24. Assumptions for the 2023/24+ medium-term plan are that funding continues at same level as in 2022/23 (£375k for LEP core funding, and £308k for Growth Hub (GH) funding, including £40k for GH cluster work).	**High** If no further funding is provided, we would need to reduce costs/activity or secure further funding/cost savings of approximately £683k per year.	**Medium**	We have enough reserves to cover the potential gap in funding in 2023/24 and 2024/25. 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 have completed our organisational review, and are implementing proposals to 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 £400k per year in total, from Local Authorities (LAs - £320k), Higher Education institutions (£50k) 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.	**High** Removal of partner funding would see a reduction in income of £400k 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 £400k per year	**Medium**	We have enough reserves to cover the potential gap in funding in 2023/24 and 2024/25. 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. We have agreed our future vision, following clarification from Government about the future funding and direction of LEPs. We have completed our organisational review, and are implementing proposals to 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.

Appendix 1: Key Financial Risks and Assumptions				
Risk	**Description**	**Impact**	**Likelihood**	**Mitigation**
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 2.25% in 22/23 (considering the current level of 3.5%); 4% in 2023/4; then fall back slightly, ending at 3.5% at the end of the medium term. This is a conservative estimate based on the latest global macro models and analysts' expectations.	**Medium** In the unlikely event that interest rates do not increase above the current 3.5%, the overall effect is a drop of £0.3m in the medium term.	**Low**	We have enough reserves to cover the potential gap in funding in 2023/24 and 2024/25, and almost to the end of 2025/26. We continue to work with RFAC to explore opportunities for further savings and additional income, to address any further gaps in the medium term.
Capital Programme	Interest on our capital balances, which are built up from past and future loan repayments, for a significant part of our annual income. We are developing our Future Fund, which will see a steady stream of capital payments/investments and loan/equity repayments. Our cashflow assumptions are that our existing Future Fund capital pot will be delivered by the end of 2023/24; and future income streams will be re-distributed 18-24 months after being received. Further we are assuming that 90% of our capital payments are in the form of loans, equity or other revolving funds; and that on average, these will be repaid over five years, starting two years after distribution.	**Medium** If our delivery is slower than assumed, our reserves balance will benefit from interest receivable on balances. For example, if all new loans/investments from our Future fund were delayed by a year, our reserves would be £0.4m higher at the end of the MTFP period. Further, due to the timing of the first expected loan repayments from new loans/investments, the effect is minimal on our medium-term plan. On the other hand, if delivery is quicker than assumed, we would nevertheless remain sustainable at the end of the medium term. For example, if we distributed all our existing funding in 2023/24, and all future funding within 12 months of receipt, our reserves would be £0.3m lower at the end of the MTFP period.	**Low**	We have enough reserves to cover the potential gap in funding to the end of the MTFP. Any delays will benefit the reserves balance. However, we will work with the Board and the Programme Steering Group (PSG) to ensure that the programme is delivered in a timely and efficient way. We continue to work with RFAC to explore opportunities for further savings and additional income, to address any further gaps in the medium term.

Appendix 1: Key Financial Risks and Assumptions				
Risk	**Description**	**Impact**	**Likelihood**	**Mitigation**
Inflation	Inflation has risen considerably in the last few months, with predictions that the rate will remain at 10%+ in the medium term. Our assumption for the MTFP is that general inflation will be at an average of 10%; and salary inflation at 5% (22/23 award now agreed at average of 5%). Salary inflation in the next three years is prudently set above the currently anticipated public sector salary inflation rate, but below currently projected general labour market inflation rates of at least 10%.	**Medium** If Public Sector salary inflation increases in line with general market predictions of 10% p.a., our reserves would decrease by £225k by the end of the medium-term financial term. We would remain financially stable. Salary inflation could increase by a further 10% in the next two years, and financial stability would remain. Anything higher would mean that we would need to make further costs savings / generate income in 2024/25. Salary inflation would need to average over 50% from 2023/24, for us to be in a financially compromised position before the end of next financial year.	**Low**	We have enough reserves to cover the potential gap in funding to the end of 2024/25 We continue to work with RFAC to explore opportunities for further savings and additional income, to address any further gaps in the medium term.