Enterprise M3 Board meeting

6 April 2023

Resources, Finance and Audit Committee Update - Item 9

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

The Enterprise M3 Board is asked to:

APPROVE: The Final Revenue Budget for the 2023/24 financial year **(Section 3)**

NOTE: The forecast 2022/23 outturn position at the end of February 2023 (Month 11) **(Section 2)**

NOTE: The LEP's sustainability projections across the medium-term, following Government's announcement relating to funding of LEP's from 2024/25 **(Section 4)**

NOTE: The key financial risks associated with the 2023/24 Revenue Budget **(Appendix 1)**

1. Executive Summary

1.1. This paper sets out the final Revenue Budget for 2023/24, and an updated forecast for the 2022/23 out-turn position at the Month 11 position (April 2022– February 2023). It also considers a number of scenarios for the financial sustainability of continued delivery of LEP functions post April 2024, under different funding assumptions.

2023/24 Final Revenue Budget (Section 3):

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 the EM3 Delivery Plan for 2023/24, endorsed by the Board in November 2022.

1.3. In February 2023, the Board endorsed the outline 2023/24 budget, subject to it being finalised once funding details emerged. Government has now confirmed 2023/24 LEP core funding of £250k (decreased by £125k compared with 2022/23); and issued a letter of comfort signalling that Growth Hub funding is to remain at the same level as in 2022/23 (subject to confirmation of individual LEP allocations). Subsequently, during the March 2023 Budget Statement, Government announced that it intends for the functions of LEPs to be delivered by local government in the future, and is minded to withdraw central government support for LEPs from April 2024, subject to a consultation exercise and a confirmed decision.

1.4. Following the confirmation of Government funding for 2023/24, we are now able to agree a final budget for 2023/24. The budget is sustainable, presenting a balanced year end position, which enables us to achieve our delivery plan, without drawing on reserves.

1.5. This final budget accounts for the reduction in core LEP funding of £125k, but the impact is small because the reduction is mitigated by:

- A higher level of estimated interest receivable on our balances, and
- An increase in useable retained reserves, arising from a better than anticipated 2022/23 out-turn position.

This means that activity assumed in the final budget remains as in the outline budget.

1.6. On 16th March 2023, the Resources, Finance and Audit Committee (RFAC) reviewed the proposed 2023/24 final budget. RFAC recommends that the Board approve it. RFAC acknowledged that, as the implications of the March Budget announcement become clearer, it is likely that we will need to review some of our planned activity and expenditure and revise the budget in-year. Approving the final budget now will provide us with a robust baseline for this, and for ensuring that we continue to deliver for Hampshire's businesses and communities during 2023/24.

1.7. The key financial risks associated with the 2023/24 budget are set out in **Appendix 1**.

Significantly:

- We are assuming that our partners (local authorities, colleges, and universities) continue to fund us at the same level as in recent years.
- We have incorporated future pay award assumptions at 5%. This is prudently above the currently anticipated public sector salary inflation rate, but below currently projected general labour market inflation rates.
- We are assuming that the Bank of England base interest rates will average 4% during the year. This is in line with current econometric models.

Financial Viability (Section 4)

1.8. The Government will consult on its announcement in the March Budget and publish an updated policy position to confirm next steps by the summer. In view of these circumstances, we are not presenting a medium-term financial plan at this point.

1.9. At present we do not know how delivery of LEP functions will be organised or funded beyond March 2024. However, to provide assurance that EM3's functions can be delivered beyond 2023/24, we have considered the implications for financial viability of a range of funding scenarios. Even with no further Government/partner funding, EM3's current functions could continue to be delivered for over two years, before the need to implement savings or secure further income. Current income streams and reserves are at a sufficient level to cover the same level of activity; this gives us time to develop and implement a robust longer-term plan.

2022/23 Forecast Out-turn (Section 2)

1.10. 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 month 11 of the financial year, shows that we are on track to exceed the target, with an overall increase in forecast net income of **+£0.7m**. This variance is primarily due to receiving more interest than anticipated when our budget was set; and due to additional savings achieved through implementation of our organisational review outputs and some consequential re-profiling of activity.

Next Steps

1.11. 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.

1.12. We will work with RFAC and other Board members to identify any appropriate changes to our plans. This will be done alongside discussions with our Local Authorities and other stakeholders, as further information emerges about the transition of LEP functions.

1.13. 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.

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 February 2023 (month 11 of the financial year) and revision of economic assumptions:

TABLE 1: EM3 Operating Income and Expenditure	2022/23		
	Budget £m A	Forecast £m B	Variance* £m C
REVENUE RESERVES Brought Forward		**2.6**	
Operating Income	*2.3*	*2.6*	*0.3*
Operating Expenditure	*(2.5)*	*(2.1)*	*0.4*
Addition to/ (Use of) reserves	**(0.23)**	**0.47**	**0.7**
TOTAL REVENUE RESERVES		**3.1**	

* 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 that income of **£2.6m** (budget £2.3m) will exceed in year expenditure of **£2.1m** (budget £2.5m), and we therefore expect to add **£0.47m** to retained reserves. This is an overall improvement of **£0.7m *(column C)***, on the budgeted draw on reserves of **£0.23m *(column A)***.

2.2. The improvement of **£0.7m** 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 - including savings achieved as a result of revised timing of staff recruitment and on-boarding. We received additional income from our Higher Education partners who agreed to contribute towards our operational costs. Reduced running costs reflect the continuing impact of the pandemic on ways of working, and in-person events. Further, we re-profiled some research and studies activity until our team was recruited; and released contingencies. Partially set against this was the higher than budgeted rise in inflation, including salary inflation.

3. 2023/24 Revenue Budget

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. This follows a review of our organisation and delivery methods, to ensure they are fit for purpose, and ongoing implementation of resulting outputs.

3.2. **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.

3.3. **Table 2** summarises our 2023/24 Revenue Budget

2022/23 FORECAST* £m A	TABLE 2: EM3 Revenue Budget	2023/24 BUDGET £m B
2.6	**TOTAL RESERVES AT START OF YEAR**	**3.1**
2.6	*Income*	*2.8*
(2.1)	*Expenditure*	*(2.8)*
0.47	**Addition to/ (Use of) reserves**	**0.0**
3.1	**TOTAL RESERVES AT END OF YEAR (C)**	**3.1**
1.0	Minimum Revenue Reserves Level (D)	1.1
2.1	**RESERVES AVAILABLE FOR USE (E)**	**2.0**

*Table 1 column B

3.4. As summarised in **Table 2 *(column B)*,** in 2023/24 we anticipate a near break-even position. We expect that operating income of **£2.8m** (2022/23 £2.6m) will match in year operating expenditure of **£2.8m** (2022/23 £2.1m).

3.5. **Income:** Overall income in 2023/24, of £2.8m, is expected to be £0.2m 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.

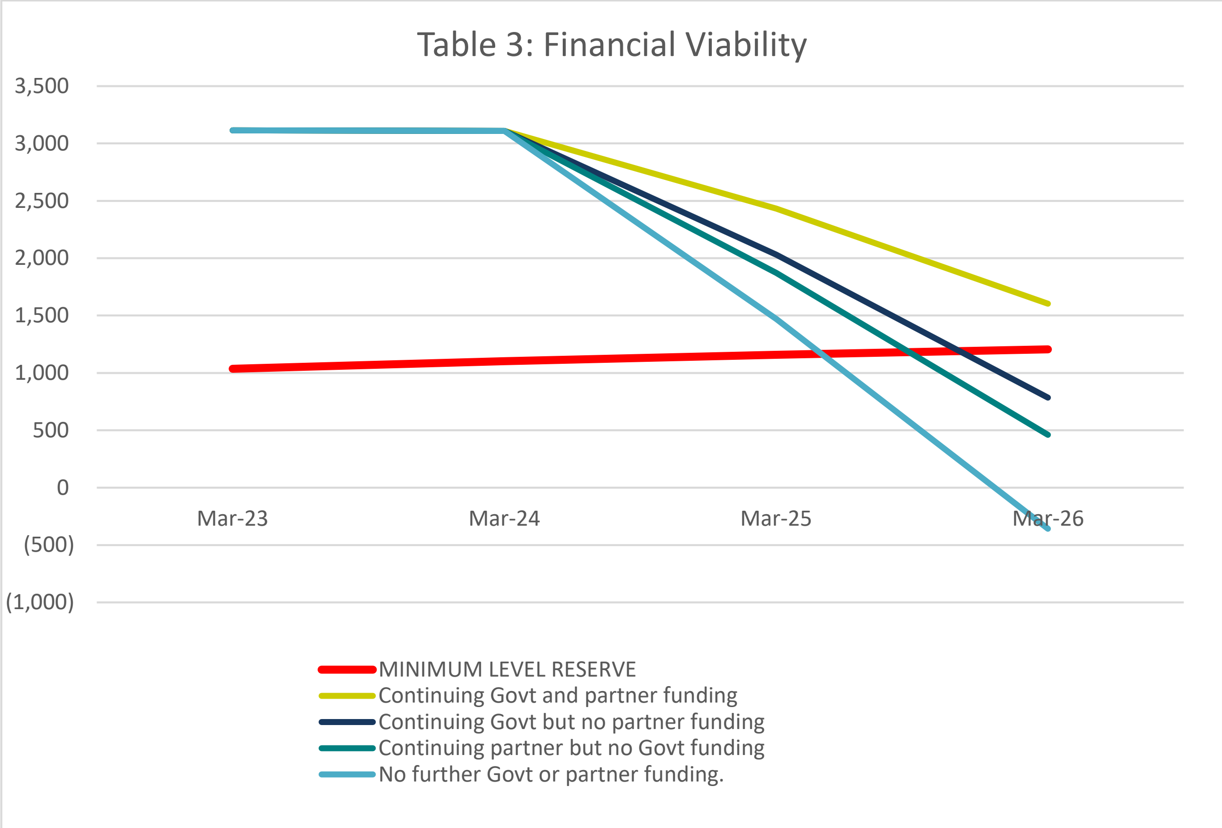
3.6. **Expenditure:** Overall expenditure in 2023/24, of £2.8m, is expected to be £0.7m higher in total than the previous year; the key points being:

- 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; and then a period of recruitment and on-boarding.
- 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.
- With a full complement of staff and associates, and planned increased marketing campaign for the Growth Hub, we expect to increase activity to reach more businesses, to facilitate higher growth in the area.

4. Financial viability beyond April 2024

4.1. **Table 2 *(row C)*** shows that we expect to retain £3.1m reserves at the end of March 2024. Our reserves policy stipulates that total reserves should be maintained at a minimum level which covers four months of annual 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. Thus, at 1 April 2024, we estimate surplus reserves of £2m (**Table 2, *row E***) will be available to fund future LEP activity.

4.2. To demonstrate the financial viability of continuing LEP functions beyond March 2024**, Table 3** projects the extent to which, in a number of Government and partner funding scenarios, reserves and other income would sustain future LEP activity. The analysis is based on activity continuing at a similar level as in 2023/24, based on **Key Financial Risks and Assumptions**, set out in **Appendix 1.** All points above the red minimum reserves level line represent a financially viable position.



4.3. The graphs show that in all cases of reduced partner/Government funding, LEP functions could be funded for over two years, at a similar level to those currently delivered. This would provide significant time to plan and implement opportunities for savings and income generation in order to maintain longer term financial stability.

4.4. The reason that the position is so robust is because:

- We are in the fortunate position of being able to use 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.

- In a change from recent years, we are no longer mainly dependant on Government funding. Interest receivable now forms the most significant funding source, representing about 40% of total income in 2022/23 and 2023/24, compared with between 3% and 10% in the previous two 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 – increasing from 0.1% to 4% in 15 months. But it is also due to the policy we have followed of issuing some of our capital funds as loans. These produce a steady interest income stream, and we anticipate that they will continue to do so.

  Conversely, the proportion of income from Government sources (including Growth Hub funding and one-off funding), is anticipated to be significantly lower, at 20% of total income in 2023/24, compared with over 50% in previous years.

Aleks Bennett - EM3 Head of Finance

30 March 2023

Key Financial Risks and Assumptions **Appendix 1**

The Board should be aware of the **key financial risks and assumptions** associated with the 2023/24 budget, and where relevant the future financial viability analysis.

Appendix 1: Key Financial Risks and Assumptions

Risk	Description	Impact	Likelihood	Mitigation
Government Revenue Funding uncertainty	Government has now confirmed funding for 2023/24 at £250k (down from £375k) for LEP core funding; and issued a letter of comfort, for Growth Hub (GH) funding, which indicates funding at the same level as in 2022/23 (£308k, including £40k for GH cluster work, subject to confirmation of individual LEP allocations).	**Low** Funding has been confirmed for 2023/24. Future Viability: Even with no further Government and partner funding, current activity could be sustained into 2025/26 before breaching the minimum reserves level.	**High**	There are enough reserves to cover potential loss of this funding for the next two years (end of 2024/25). This would provide significant time to plan and implement opportunities for savings and income generation in order to maintain longer term financial stability. 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.
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. 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.	**Medium** 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. Future Viability: 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 are working with our LAs to ensure they continue to match our funds. There are enough reserves to cover potential loss of this funding for the next two years (end of 2024/25). This would provide significant time to plan and implement opportunities for savings and income generation in order to maintain longer term financial stability. 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.

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 4% in 2023/4. This is a conservative estimate based on the latest global macro models and analysts' expectations. For financial viability analysis we assume they will fall back slightly, ending at 3.5% at the end of the medium term.	**Medium** In the unlikely event that interest rates run at an average of 1% below current assumptions, the overall effect is a drop of £0.4m across three years.	**Low**	We have enough reserves to cover a gap in funding arising from a 1% fall in interest rates, to the end of March 2026. 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.
Capital Programme	Interest on our capital balances, which are built up from past and future loan repayments, forms 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** Future Viability: 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 March 2026. Further, due to the timing of the first expected loan repayments from new loans/investments, the effect is minimal on our medium-term plan, should less than 25% of Future Fund funding be issued as loans. 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 March 2026.	**Low**	Any delays will benefit the reserves balance. However, we will work with the Board to ensure that the programme is delivered in a timely and efficient way. 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.

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 is that general inflation will be at an average of 10%; and salary inflation at 5% (23/24 award now being offered at average of 4.5%). Future Viability: 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 £0.45m by the end of March 2026. We would remain financially stable until the latter part of 2025/26, without making further costs savings / generating income.	**Low**	We have enough reserves to cover the potential gap in funding. 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.