MARCHES LEP BOARD MEETING PAPER

Meeting date:	24 March 2020					
Agenda Item:	8 b					
Item Subject:	Capitalisation of Growth Deal Funds					
For:	**Discussion**	x	**Decision**		**Information**	

Purpose:
To set out the reasons for seeking Board support to allow Growth Deal Funds to be used to cover the direct costs of managing the Growth Deal Programme.

Recommendations:

- To ask the Board to support the proposal that the Accountable Body Section 151 Officer be asked to utilise Growth Deal Funds to cover the Growth Deal Programme costs in the next Financial Year to help maintain the financial viability of the LEP and to enable the LEP reserves to be maintained at an acceptable level.

Background:

Over the past 5 years the LEP has maintained funds in a general reserve of approximately £0.8m to £0.9m, to ensure it could meet its liabilities into the next Financial Year. For the Financial Year 2020/21, however, the LEP will be incurring a range of additional costs as outlined below. LEP income of circa £0.8m per annum, including interest on reserves, is not expected to increase. Consequently, the LEP will need to draw on its reserve to cover operating costs in 2020/21, a position that is not financially sustainable. Outlined below are the additional costs, some of which are annual, base budget commitments, and others that are one-off costs for 2020/21 Financial Year.

1. Additional annual costs for the LEP

a) Corporation Tax, VAT & Accounts Preparation in 2019/20 and 2020/21

As a consequence of the LEP becoming a Company Ltd by Guarantee from 1 April 2019 it is estimated that the LEP will incur the additional annual costs listed below. Legal advice has recently confirmed that we cannot recover any VAT liability and will be liable for corporation tax on interest earned on reserves.

- VAT at 20% for LEP and Growth Hub services - circa £0.1m per annum
- Corporation Tax at 19% on interest earned on reserves - circa £0.03m per annum
- Preparation of external accounts and external audit - circa £0.03m per annum

The LEP will need to make an allowance to pay the VAT and tax liabilities for Financial Year 2019/20 and 2020/21 in the 2020/21 Financial Year as the relevant legal advice confirming this position has only recently been received.

b) Extra Staff in the LEP team

Between January 2020 and June 2020, the LEP team will have recruited three new members of staff: a project assistant, a partnership administrator and a Corporate Director. The creation of the Corporate Director post was agreed by the Board last summer and the other two posts by LEP CEO and the LEP Chair to provide additional capacity in a very busy team. The salary budget increase from 1 April 2020 for the 2020/21 Financial Year (including on-costs and the annual cost of living uplift for all staff) will be circa £0.126m. We are also in the process of recalculating the additional redundancy and pension deficit for the LEP team which will need to be taken into account. The current figure is £170k.

One-off costs in 2020/21

a) **New LEP website** - The LEP website has not been updated since 2015. It is estimated a new LEP website will cost circa £0.03m
b) **External support to manage the Growth Deal Underspend –** the LEP Team has had to procure an independent technical evaluator, solicitors and additional temporary project management staff to ensure all GD funds are contracted as quickly as possible in early 2020/21. It is estimated this will cost circa £0.075m plus VAT.

2. Implications for the LEP reserves

Based on the Feb 2020 finance update the LEP is projected to carry forward reserves of just over £1.2 m from 2019/20 through to 2020/21 FY. Therefore, the income for 2020/21 based on current estimates will be:

Reserve Carried Forward	£1,200,000
Interest on reserves from 2019/20	£120,000 (TBC)
MHCLG contribution	£500,000
EZ contribution	£100,000
Local Authority Contributions	£83,000
	£2,003,000

The LEP draft expenditure for 2020/21 including additional and new costs referenced earlier in this paper is £1,338,122, which will leave a reserve balance for 2021/22 of £664,878.

3. Actions to build up LEP reserve in 2020/21

To ensure the LEP can afford to meet all of its financial liabilities in future financial years it is proposed the LEP secretariat, with the support of the Board, need to undertake a number of actions.

The LEP has received the same £0.5m per annum from the government towards core costs since 2014/15, with no uplift for inflation, growth or size of the operation under management. In the first instance the LEP Chair and CEO will lobby government via the LEP network to increase its annual contribution and lobby with other LEPs via the LEP network to obtain a VAT and tax exemption for LEPs.

The Performance, Risk and Monitoring Committee (PRMC) have asked the Section 151 Officer to look into whether Growth Deal Funds could be used to cover the Growth Deal Programme costs in the next Financial Year. This approach would help maintain the financial viability of the LEP and would enable the LEP reserves to be maintained at an acceptable level.

The Director of Finance, Governance and Assurance (Section 151 Officer) for the LEP, James Walton, has advised that Growth Deal Funds are defined as capital and as such the Section 151 Officer would need to satisfy himself that all costs charged are capital in nature and this means, on a practical level, only those costs directly attributable to bringing an asset into use. Costs associated with appraising schemes that progress, up to the point of signing the agreement, could be considered, for example, but costs for schemes that do not progress could not. It is a requirement that the Section 151 Officer signs off an annual statement confirming that the grant has been spent on capital. This requirement will undoubtedly stifle some flexibility to ensure the LEP does not carry undue risk. Furthermore, there is a risk that the LEP would suffer reputational damage, future funding could be impacted, and/or current grant clawed back if the government do not approve or accept the LEP or the Section 151 Officer's interpretation of capital spend. To this end it would be prudent to consider what action could be taken in such a scenario. Unfortunately, given the driver for this approach is to create a basis for financial sustainability for the LEP, there is little that could be done within the LEP to rectify invalidation of this approach and the revenue impact would therefore, in likelihood, fall on the three local authorities.

It should be noted that several LEPs have been charging a fee or taking a percentage from their Growth Deal funds for some years now to cover their programme management costs. The Marches LEP to date has held sufficient reserves to cover its operating costs. This is, however, no longer the case as a result of the need to cover VAT, Corporation Tax, increased staffing, redundancy and pension liabilities that will exceed the available funding.

The LEP has recently received £24.8m, from the Dept of Transport, of the £27m which had been awarded to the South Wye project. The repayment of £3.8m (£2.2m from DfT and £1.7m from Growth Deal) is currently the subject to legal discussions between the LEP and Herefordshire Council.

Financial implications:
The on-going LEP operating costs, with increases directly attributable to the increase in grant funding administered, and with no increase in funding from MHCLG or Local Authorities, are in excess of available income. This position is clearly not financially sustainable.

	2020/21	2021/22[1]
Ongoing Revenue Costs	1,151,000	1,174,000
Ongoing Revenue Funding	£683,000	£683,000
Estimated shortfall in Revenue Funding	£468,000	£491,000

Without an amendment to current arrangements, LEP reserves are estimated to fall from £1.1m in 2019/20 to approx. £0.66 m by the end of 2020/21 and would potentially be exhausted in 2021/22.

The LEP Board agreed in March 2018 to ensure the LEP held a reserve of £630k by March 2021 which would enable it to ensure it was able to meet all of its project monitoring and wind-up costs by 2024. However, the actions outlined in the LEP Review issued by Government in June 2018 has resulted in the LEP having to incur a range of additional costs related to governance and transparency improvements, strategy development and the consequences of becoming incorporated. Whilst the LEP received an additional £400k from the Government in 2019 to implement the Review these funds had to be allocated and spent in 2019/20 and the consequences of these changes have meant the LEP now has increased annual costs from 2020/21 FY.

The Growth Deal funds are awarded to the LEP’s accountable body under a section 31 capital grant.

[1] Costs assumed to increase by 2%, no uplift in funding.

With an amendment to current arrangements, the Accountable Body Section 151 Officer will need to review the regulations governing section 31 capital grants with a view to enacting the amendments approved by the LEP Board resulting from this report. Initial estimates by the LEP team suggest up to £0.3m per annum could be considered for capitalisation.
Legal implications: None
Risks, opportunities and impacts: If a charge is not made to Growth Deal funds, the LEP will either need to reduce its staffing and other operational costs or seek additional contributions from stakeholders. The three local authorities already contribute circa £80 - £100k /annum per annum in total to support the LEP team costs. This contribution has not been increased since originally agreed in 2014/15. It is a requirement that the Section 151 Officer signs off an annual statement confirming that the grant has been spent on capital. This requirement will undoubtedly stifle some flexibility to ensure the LEP does not carry undue risk. Furthermore, there is a risk that the LEP would suffer reputational damage, future funding could be impacted, and/or current grant clawed back if the government do not approve or accept the LEP or the Section 151 Officer's interpretation of capital spend. To this end it would be prudent to consider what action could be taken in such a scenario. Unfortunately, given the driver for this approach is to create a basis for financial sustainability for the LEP, there is little that could be done within the LEP to rectify invalidation of this approach and the revenue impact would therefore, in likelihood, fall on the three local authorities. Initial estimates by the LEP team suggest up to £0.3m per annum could be considered for capitalisation. Invalidation of the approach in year one could be managed by utilisation of reserves. In future years, however, the accrued value of this approach would increase by £0.3m per annum and thus the accumulated risk value would soon exceed available funds if, for example, claw back was initiated. To mitigate this risk, a statement would be produced setting out the basis for charging costs to Growth Deal. Furthermore, quarterly returns would be sent to government for spend incurred and this would provide the opportunity for government to flag any spend they deem to be ineligible.