

Commercial in Confidence

Herts IQ Board

Agreed Finance Principles

July 2020

Operational Budget Spend

In July 2020 delegated authority for decision making on spend of Herts IQ operation budget was agreed as follows:

- All procurement must be in line with Herts County Council procurement rules, or the Local Authority partners' procurement rules if they are leading the commission with Herts IQ funding contribution.
- Budget spend approvals by Herts IQ Project Team and Board will ideally be sought at each respective quarterly meeting, but where decisions are time-bound approval can be sought/given electronically via email. For both Project Team and Board, of the 7 partners, members with voting rights on Herts IQ financial matters are Hertfordshire LEP, Hertfordshire County Council, St Albans City & District Council and Dacorum Borough Council. Decisions relating to financial matters must be unanimous. Other Board and Project Team members, those being representatives from Rothamsted, BRE and the University of Hertfordshire, must also be included on any emails requesting spend approval to ensure good governance and transparency, and their comments may be considered. All approvals will be minuted and electronic approvals will be recorded and minuted at the next meeting.
- Proposed delegated authority levels for operational budget spend approvals:
 - Up to £5k Herts IQ Programme Manager
 - £5k - £10k Herts LEP Operations Director
 - £10k - £30k Herts IQ Project Team
 - £30k + Herts IQ Board

It is considered that these authority levels allow an appropriate balance of operational efficiency and financial oversight.

Updates to Agreed Principles:

On 15th July 2020 the Herts IQ Board approved further updates to the financial principles in order that they continue to support the evolving status of the project.

On 30th January 2019 the Herts IQ Board requested that this report sets out all agreed principles for financial reporting within appendices.

The original principles were agreed July 2018.

Finance Paper Section 2 Decision Required – Agreed Principles

- That this paper sets out the overarching principles for financial management of the Enterprise Zone
- Whilst the principles are set, the financial position will be updated and brought to the Herts IQ Board in a single report each quarter
- It is the best understanding of the projects financial position at the time of writing
- It has been approved by all local authority partners' senior financial representatives through the Herts IQ quarterly Project Team meetings.

Finance Paper Section 3 Operation Budget – Agreed Principles

- EZ Budget items will be defined as 'operational', for budget items related to the core operation of the project, and 'exceptional' for investment budget items.
- Draft annual budget approval will be needed in October in order that any implications for the Local Authority partners can be considered in November, with final EZ approval in January, and implementation 1st April.
- If circumstances arise which require amendments to the operational budget, these can be taken to the EZ Partnership Board for approval.
- Sufficient contingency will be provided for in the operational budget.

Each quarter, the budget will be reviewed by the Herts IQ Board to check whether the project is on track with the budget, or if any amendments have been proposed by the Project Team.

Finance Paper Section 4 Cash Flow Forecast – Agreed Principles

The Herts IQ Project has been financially self-sufficient from an operational budget perspective since April 2020. Cash flow support is no longer needed, although Herts LEP will continue to host the Herts IQ team and facilitate the operational budget spend. Repayment of all operational debt and 'sunk costs' to partners is being completed during Summer 2020.

On 24th April 2019 it was noted by the Board that the principles should reflect that the Herts IQ Board needs to approve all transfers of funds from HCC to the LEP for operational funding or repayment of debt related to both operational and investment items.

Operational budget approval thresholds

Insert wording regarding approval thresholds for Herts IQ operational budget spend once agreed by the Board 15th July 2020. These thresholds were specified and documented following the March 2020 audit of Herts IQ governance and reporting processes.

Forecast validation

- Each quarter, in preparation for drafting the Herts IQ Board Finance Paper, the Project Team will revalidate the development assumptions, in order that the cash flow forecast is founded on the most accurate possible information at that point in time.

- The EZ Manager is responsible for co-ordinating this validation process and seeking updated information from the seven landowners. Those currently responsible for supporting the process are:

Planning Teams	Dacorum Council	John Chapman
	St Albans Council	Ruth Ambrose for TCE site
Business Rates	Dacorum Council	Chris Baker
	St Albans	Richard Skilbeck
Modelling	HCC	Lisa Blaney

- The process for revalidating the development timeline and forecast income is:
 - Comparison of development information from multiple sources: district council planners, developers, land owners, the commercial property market.
 - Following this comparison, an updated development forecast is produced by the EZ Manager for review by the DBC and SADC business rates teams.
 - The two business rates representatives will review the current development assumptions, update the forecast business rates income and provide a current forecast to the EZ Manager and HCC Finance within a week.
 - They will consider the latest information available from NNDRs, any local precedent in terms of unit valuation and in terms of occupier challenge to a valuation, and where possible actual business rates collected.
 - It is recognised that the NNDR data may be slightly higher than actuals due to the process of BR adjustments; however the risk adjustment factor against the cash flow will provide sufficient mitigation for the forecasting process.
- Any major changes or newly emerging risks will be highlighted. It should be noted that most cases, only the developer knows their actual intentions and timelines, so the project team will be attempting to forecast using the approach above.

Transfer of funds from the EZ business rates income collected by local authority partners

- Business rates will be collected by each of the district councils and transferred to HCC. HCC as the Accountable Body for the EZ will hold these funds on behalf of the EZ. The expectation is that funds will be transferred on the basis of actuals received.

Other agreed principles

- Cash flow forecast is based on current value without inflation applied, as agreed by the Herts IQ Board 27th April 2018.
- Business rates relief will not affect the forecast income; the EZ project retains 100% of the business rates and the relief is a reimbursement from MHCLG.
- 15%, 10% and 5% risk deflator is being applied to the business rates income for future years.
- The process for business rates forecast income validation can be reviewed if the EZ finance representatives or Herts IQ Board requires this, recognising that confidence in the modelling will build over time, as the process of income reporting matures through the life of the project.

Finance Paper Section 5 Exceptional Budget Items – Agreed Principles

Exceptional budget items are the infrastructure and economic development investments that the Herts IQ EZ will make, funded from business rates income, to improve the outcomes of the EZ project. Each investment will require its own business case and funding proposal, which will be validated by the Herts IQ Project Team, including local authority finance representatives, in advance of submission to the Herts IQ Partnership Board. A consideration in every business case will be the extent to which funding of the proposed investment would risk the funding of junction 8 improvements.

Depending on the scale of investment and any upfront borrowing required, each partner organisation may also need to seek individual approval to agree to any exposure to financial risk. Herts LEP may be asked to facilitate upfront borrowing for some investments from Growth Deal funding (or other funding programmes). Where this is the case, the timeframe for repayment of the borrowed funds will be agreed before final approvals are given and will be set out within the projects repayment schedule. The governance and approvals processes related to exceptional budget items is being reviewed in Summer 2020 and will be documented separately from these finance principles.

The implication of the projects ability to fully fund a commitment should the EZ end for any reason, will also be considered with any exceptional budget item proposal. The full picture of cumulative borrowing / forward funding of for all investments should be included in each business case, so that an individual item investment can be considered in the context of other repayment commitments the project is already committed to. Whist this is captured in the repayment schedule, it will also be included with any future funding requests.

The priority investment for Herts IQ is the funding for the M1 Junction 8 improvements, which was a key driver for seeking EZ status, and without which the wider development would not be viable.

In order to ensure sufficient provision is made to fund the Junction 8 improvements, 75% of surplus income - i.e. after operational costs and current commitments, will be ring-fenced specifically to fund this scheme, with 25% of income being available to fund other exceptional budget / investment items approved by the Herts IQ Partnership Board.

This ratio split can be reviewed when a clearer view of likely costs for J8 is available, if there is concern that 75% of surplus is not sufficient funding provision.

Investments

Investment 1: Upgrade of Junction 8 of the M1

Indicative cost: EZ estimated contribution £65m (full funding proposal to come when costs are clearer, towards the end of the J8 design project in 2021/22)

Indicative cost of borrowing: £15m

Indicative timeframe: 2023 onwards

Funding Provision: 75% surplus income

This is the priority investment for Herts IQ. Without this intervention, the scale of proposed commercial development across the EZ becomes unviable. Funding for other investments will be approved on the basis that they do not adversely affect the funding for the Junction 8 improvements or delay the delivery of this core infrastructure.

The proposal for £3m for M1 Junction 8 acceleration of design and preparatory works is part of this 75% allocation of funding, not in addition to it. The LEP Board approved The Crown Estates bid for £3m funding for the Junction 8 Accelerator project on 20th June 2019 (now known as the J8/Breakspear Design Project). This is being matched by £3m of their own, to give a £6m work programme of design and preparatory works to get the scheme to a 'shovel ready' status. The breakdown of repayment to the LEP by the project is set out within the repayment schedule and is forecast to be repaid in full by FY 2023/24.

Wider Context

The Aecom report that was presented to the September 2016 EZ Partnership Board gave indicative costings for the Junction 8 works ranging from £35m to £200m. At that point the scenarios and land take possibilities varied enormously. There has been extensive refinement of scenarios since then.

The most recent indicative cost is £30m, which was detailed in the November 2017 Maylands Growth Corridor Study Prospectus, with likely delivery between 2023-2028 depending on planning and construction timeframes.

However, this estimate is considered far too low based upon experience of other major infrastructure investments, the scale of the works required and potential risks involved. Provision will be made within the project to fund up to £65m although it is anticipated that the scheme may actually require nearer £120-130m of funding in total, which it is expected would be funded not only by EZ contribution, but also with contributions from The Crown Estate, Highways England, and from central government funding such as RIS3 (Road Infrastructure Scheme 3).

Until the J8/Breakspear Design Project is complete it is difficult to be more precise with the estimate of likely costs. For EZ budgetary and forecasting purposes £65m will be used, with £15m borrowing costs based upon PWLB rates.

Securing borrowing

It is expected that the EZ will need to borrow funds under Public Works Loan Board (PWLB) to fund its contribution to the J8 highways works, to be repaid as sufficient income is accrued. The cost of borrowing is likely to be in the region of £15m based on current estimates and PWLB rates. However a far more accurate estimate will be calculated for both the capital costs and the cost of borrowing once the detailed design and scoping works have been completed.

The 2016 HCC cabinet paper set out that there was likely to be a need for borrowing to facilitate highways works, with the EZ repaying the borrowing, although at that time the detail of the likely amount of borrowing was unknown. Therefore in principle, HCC expect to support the required borrowing, but until more precise cost estimates are available this cannot be taken back to HCC Cabinet for full approval. At this point it is not expected the districts would be asked to make provision for borrowing.

On completion of the J8/Breakspear Design Project, there will be a decision point for the Herts IQ Board and HCC. At this point full infrastructure costs should be known and the required share of funding by TCE, other government funding sources and Herts IQ should be clearer. The project will then know whether the provision being made through though the project is sufficient and what level of borrowing is needed.

In terms of mitigation of risk against borrowing should the EZ end for any reason, at the point when costs and the volume of required borrowing are known, the partners can take a decision on how the exposure to debt would be mitigated, should the EZ end. At that point there will be far more clarity of the business rates income forecasts as development will have progressed across other sites.

Investment 2: BRE Open Innovation Hub

Known cost: £2.2m

Approved by Herts IQ Board 29th January 2020. Funding provision has been made within the Herts IQ financial forecasts, for investment in new commercial space for small and innovation business growth, since the outset of the Herts IQ Project.

Investment 3: Rothamsted Innovation Grow-On Hub

Indicative cost: £2.5m

Indicative timeframe: 2022/23

Funding Provision: 25% surplus income

In October 2019 the Board approved £866k of this allocation as match funding for refurbishment of The Russell Building, leaving £1,634k for future investment.

At the outset of the Enterprise Zone project, the Partnership Board expected the project to contribute towards funding new enviro-tech innovation / incubation facilities at both BRE and Rothamsted sites. At 27th April 2018, the Herts IQ Board requested that provision be made for £2.5m funding towards facilities at Rothamsted.

Other potential future investments include:

- Match funding for transport infrastructure improvements
- Match funding for public / sustainable travel improvements
- Enviro-tech incubation / innovation spaces on the Maylands sites
- Skills support, possibly brokerage

As stated above, all investments would need a robust business case and funding proposal including consideration of the 75/25 funding split and impact on J8 funding, and existing commitments in the repayment schedule.

Finance Paper Section 6 Repayment Schedule – Agreed Principles

- The Herts IQ EZ repayment schedule will be included as part of the quarterly Herts IQ Partnership Board Finance Report.

- As business rates income flows into the project, funding will be accrued for investments on the 75/25 split referred to above in order to ensure sufficient provision for J8.
- Repayment of debts for investment/exceptional budget items is after funding of the annual operational budget
- £50k will be retained in the project for contingency, in addition to the annual EZ Operational Budget.

Repayment schedule priorities:

- 1) J8 design accelerator work package – funded from the 75% of income being allocated to the wider J8 project delivery
BRE Open Innovation Hub
- 2) 75% of surplus income, after points 1-3, to be allocated to Junction 8 improvements
- 3) 25% of surplus income, after points 1-3, to be allocated to other EZ investments as outlined in section 6 Exceptional Budget Items, including Rothamsted Russell Building

The repayment schedule models all repayments based upon these principles.

Finance Paper Section 7 Pooling of Surplus Income – Agreed Principles

Agreed Principles - general

As pooling is only relevant to surplus income after all project investments are complete and all borrowing repaid, the principles are not likely to be applied in practice for many years. Therefore at this point Herts IQ Partnership Board agreement of these principles is sufficient; there is no need for this to be supported with a separate MoU. This can be reviewed in future years at an appropriate time, on the recommendation of the Herts IQ Partnership Board and local authority finance representatives within the Project Team. This finance paper and its recommendation will be cross referenced with the last versions of the MoU draft for completeness of audit trail, referring to the principles stated here and that the terms of the MoU can be revisited in the future when application of the agreement is more relevant.

Agreed Principles – sharing future surplus income

The original MoU with DCLG stated that pooling ratios were subject to local change. The original ratios were:

- 10% DBC & SADC (to be shared)
- 5% HCC
- 35% EZ operational & site investment
- 50% LEP development

The proposed ratios that the EZ project has been considering since late 2017 are:

- 40% to LEP
- 10% to HCC
- 50% to be split between DBC & SADC

A factor that influenced the proposed change of ratio in early 2017 was that indications from government around Local Authority's ability to retain business rates had changed through

2016/2017. Partners felt that the proposed ratios give a more equitable model, as the government's original proposals around local authority business rate retention did not materialise.

All partners are working on the principle that the primary purpose of business rate income is investment in successful delivery of the EZ and the core infrastructure that it needs. Only after the Partnership Board has agreed that all investments are complete and all borrowing repaid will partners take a share of any surplus funds.

All business cases for future investment / exceptional budget items will include detail, based on the latest EZ financial forecasts, of the implication of that investment on the availability of future surplus to each of the partners.

The original ratios in the DCLG MoU stated only 35% of BR income could be used for EZ operation and development. The revised model gives a clear indication of all partners' commitment to the success of the EZ project.

- All investments are to be fully funded and any borrowing fully repaid before any surplus is shared between parties.
- Pooling ratios can be reviewed and revised with full agreement of partners
- Initial split between SADC and DBC will be 50/50.
- At the point consensus is reached that investment is complete and the EZ moves to a surplus generating position, a Partnership Board review is undertaken to agree a supplementary adjusting between the two district councils. This would align the surplus income received by each party to the same ratio as the business rates income actually generated in their areas over the 25 year period.
- The EZ period ends after 25 years with all partners having made an equitable contribution to the infrastructure investment.

Finance Paper Section 8 Approvals – Agreed Principles

The Herts IQ Partnership Board Terms of Reference recognises that a decision by the Partnership Board does not commit the partner to that decision, until the member's own governance body has also approved the decision. Wherever there is exposure to financial risk in the EZ project, which is shared between any of the local authority partners (HCC, SADC, DBC and LEP), that partners Board, cabinet, or Portfolio Holder if within a delegated authority level, will need to approve that risk exposure, as well as the Herts IQ Partnership Board.

1. LEP Board
2. Council cabinet / PH for HCC, DBC, and SADC

Finance Paper Section 9 Supporting Financial Models – Agreed Principles

Each quarter the Herts IQ Partnership Board Finance Report forecasts that are presented alongside the finance paper will include:

- Overall Cash Flow
- Part 1 Report
- Operational Budget Monitor
- Following years draft operational budget when appropriate
- Exceptional Items Budget



- Repayment Schedule
- Leveraged funding