Department for Communities and Local Government

WEST MIDLANDS ERDF LOCAL MANAGEMENT COMMITTEE 2007-13

September 2012

Item 5: Position of each Priority Axis and Future Investment Strategy

Objectives:

i To review levels of commitment, risk and demand under each Priority Axis

ii To determine the most appropriate investment strategy to ensure the full value of the Programme is committed by December 2013, and all monies are spent by December 2015;

iii To agree:

- the focus and timing of final bidding rounds; and
- whether further changes to the financial tables should be negotiated with the Commission in order to reallocate funding to priorities which are experiencing higher levels of demand, and are more able to spend and deliver results by December 2015.

iv To present Version 4.2 of the Investment Frameworks for Priority Axes 1, 2 and 3 to LMC members for endorsement

Recommendations:

i To approve version 4.2 of the Investment Frameworks for Priority Axes 1, 2 and 3;

ii In the event that insufficient value or quality of proposals come forward under the current Priority 1 call, for funds to be reallocated to priority axes with higher levels of demand;

iii To launch a Priority 2 bidding round to bring forward projects to take up the balance remaining, and to establish a reserve list of projects to take up further funding in the event it becomes available;

iv To launch a Priority 3 bidding round to establish a reserve list of projects to take up further funding in the event it becomes available; such a call to be open for projects to come forward from all package areas as well as all other deprived areas of significant population across the West Midlands;

v For the above bidding rounds to be open both for new projects to come forward and for existing projects (which are performing well) to bid for additional funding to provide additional impact;

vi To agree whether in the event of underspend against this year’s package level spend targets, the deficit will be deducted from the associated package allocation as occurred in 2011, or whether slippage should be considered going forward on a project by project basis.

vii For unused funds which become available through slippage within package projects to be placed in a central pool which will be made available to the reserve list of projects established through open bidding to be the most ready to spend and deliver impact;

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vii To set a deadline for the submission of appraisal ready full applications from North Staffordshire and Coventry and Nuneaton packages to bring these packages up to 100% commitment by February 2012.

1. Background

1.1 The Commission has confirmed that the last date that the programme can legally commit funding to new projects is 31 December 2013. The absolute final date for defrayment is 31 December 2015, and in the case of land and property projects the eligible premises must also be completed on site by this date.

1.2 The financial allocation available under each Priority Axis is agreed with the Commission and is set out in the Operational Programme. The amount of funding which can be claimed is capped at these amounts. It is not possible to make amendments to these allocations without negotiation and agreement with the Commission. It is therefore important to consider whether the Priorities with a balance remaining will have sufficient demand to absorb their full allocation. Where there is not considered to be sufficient demand, it would be prudent to negotiate a revision to the financial tables to reallocate funding to Priorities which are experiencing the highest levels of demand so that vital funds are not lost to the region at the end of the programme period.

1.3 At the last LMC meeting, the following actions were agreed in order to bring the programme in on balance:

i) A greater value of projects should be accepted into the pipeline than the balance remaining in each Priority in order to account for the low conversion rate from pipeline to contract;

ii) Once full programme commitment levels have been met, a list of eligible reserve projects should be established which can be brought forward quickly and which will deliver by December 2015. The latest date for commitment to these projects will be December 2013. These projects will be taken through appraisal, but will not be presented for an investment decision unless funding is available. Care will need to be taken in managing applicants expectations in this regard.

iii) To identify a list of projects in delivery which have demand to take up additional funds post December 2013 and promise to deliver additional impact. Additional funds which become available post December 2013 could be made available to these projects via contract variations subject to the submission of a change request and a successful reappraisal of the same.

iv) To monitor the levels of demand in the Priority 1 bidding rounds, and should insufficient value or quality of satisfactory outline proposals come forward to consider reallocating funds to Priorities experiencing higher levels of demand;

v) At the September LMC, to agree the timing and focus of the future bidding rounds, and consider what, if any, changes may be required to the Programme's financial tables, so that they may be negotiated with the Commission by the close of the year.

vi) To monitor levels of project slippage closely to avoid funds being lost to the region.

1.2 In August, Philip Cox, the Director of Local Enterprise, Regeneration and European Programmes at DCLG wrote out to all LMC Members to set out the Department's policy on commitment levels, the letter is summarised below:

- The LMC and the Programme Delivery Team (PDT) should work with local partners to bring forward new and pipeline projects to raise contractual commitments to 100% of the programme value as soon as possible;

- Secondly, the PDT is encouraged to actively manage out existing projects which are underperforming and not spending their funding in line with agreed profiles, with a view to quickly reallocating unused monies to new projects that can spend;

- Once 100% of the programme value has been committed, DCLG programme board may consider some level of over commitment on a case by case basis, giving due regard to recent changes to HM Treasury rules which mean that DCLG has to bear the risk from foreign exchange rate movements for all English programmes

1.3 A substantial period of time has elapsed since a number of projects in the pipeline received their outline endorsement. Therefore, in early summer, the Programme Delivery Team wrote out to these applicants to remind them of the need to bring forward their full applications promptly. Projects have been given until 31 August to submit their full applications. Where applicants are not able to submit full applications, funds will be released to allow other more viable projects to come forward, so that vital funds are not lost to the region.

1.4 The LMC Subcommittee met on 10 September to consider the future investment strategy for the programme and the views of the subcommittee have been reflected in the recommendations presented within this paper.

2. Priority 1: Promoting Innovation Research & Development

2.1 This priority has an allocation of €145M (£123.5m) to increase investment in research and development by helping businesses take forward new innovation; encouraging the transfer of knowledge; and developing and demonstrating new technology.

2.2 According to v4.2 of the Investment Framework presented with this paper, 61% of the priority allocation is committed, a further 8% approved subject to contract, with pipeline projects totalling a further 11% (£13.6M). This leaves a balance remaining of £25m (20%) for new projects to come forward. However, since the production of the Investment Framework this figure has increased to £29.4m due to the withdrawal of two pipeline projects.

2.3 A Priority 1 bidding round was launched in June with the aim of fully committing the Priority. The call closes on 21 September. The Programme Delivery Team held meetings with senior members of the regional universities and wider innovation community in early summer in order to stimulate demand for the call.

2.4 After a slow start, interest in the bidding round has increased, and the Priority Manager has held surgery sessions for a number of potential projects. An update will be provided at the LMC Meeting, by which time the bidding round will have closed.

2.5 The average conversion rate from past bidding rounds is around 45%. Therefore to be sure of committing the total remaining balance, the LMC would need to accept projects of double this value into the programme pipeline (i.e. £60m). Whilst there is evidently demand for Priority 1, it seems unlikely that this value of quality proposals will come forward. Should this be the case, then the LMC will need to consider reallocating some funding from Priority 1 to the other main Priority Axes.

3. Priority 2 Stimulating Enterprise Development

3.1 This priority has a revised allocation of €142.2M (£121m) to support high growth business; improve business productivity, innovation or resource efficiency; support trade development; provide business finance and support a strong entrepreneurship culture.

3.2 According to version 4.2 of the Investment Framework presented alongside this paper, 73% of the priority allocation is in delivery and a further 7% approved subject to contract. The pipeline accounts for a further 16% (£19.2m). This leaves a balance remaining of £5.2m (4%). Since the production of the Investment Framework, the balance has increased to **£5.6m,** due to the withdrawal of a pipeline project.

3.6 Other than the call this spring targeted at small business loan projects, the last open bidding round for Priority 2 was more than 12 months ago. This call was heavily over-subscribed, and at the time, there were insufficient funds available to afford all the eligible proposals which came forward.

3.7 Approaches have since been made to the PDT regarding other potential Priority 2 proposals; and we are aware that a number of Priority 2 projects in delivery are keen to bid for further funds. In addition, a number of project concepts put forward in the current Priority 1 bidding round have been found to align more closely with Priority 2.

3.8 The broader nature of Priority 2 means that there is a greater pool of potential applicants than in Priority 1. Priority 2 projects are also more able to use SME contributions as match funding within the eligibility rules for the programme, as the nature of the business support provided makes it easier to use procured intermediaries to deliver the support. Business support projects under Priority 2 also tend to be more scaleable, especially when compared to capital projects under Priority 1 or 3. This is a useful characteristic as we approach the end of the Programme.

3.9 On the above basis, we believe there is demand for Priority 2. It is recommended that a Priority 2 bidding round is launched to bring forward projects to firstly take up the £5M remaining, but also to establish a reserve list of projects which can take up further funding in the event it becomes available through further slippage, project withdrawal, exchange rate gain or clawback. It is recommended that this call be open for new projects, and for existing projects which may wish to bid for further funding to provide additional impact.

3.10 Depending on the outcome of the Priority 1 call, the LMC should consider viring funds into Priority 2.

4. Priority 3 Achieving Sustainable Urban Development

4.1 This priority has a revised allocation of €99.8M (£85m) and is predominantly delivered through geographically focused packages. Projects supported under this priority aim to stimulate renaissance within deprived urban areas by regenerating local areas; encouraging investment and the location of new businesses; creating job opportunities and linking these to communities most in need.

4.2 Considered as a whole, 59% of the priority allocation is in delivery and a further 27% approved subject to contract, the pipeline accounting for a further 15%. This means Priority 3 is currently over programmed by 4% (£3.1M).

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Packages

4.3 The picture becomes more complex if we consider the position of the packages, which each have an allocation against which they are able to bring forward projects for approval.

4.4 Levels of spend and commitment for each package are shown in Annex 4. Package Managers have also been asked to provide a forecast against this year's target and the returns are provided in the annex.

4.5 Members will note that the majority of packages are now fully committed or have projects up to the value of their allocation approved subject to contract. The exceptions to this are the North Staffordshire Package and the Coventry and Nuneaton Package both of which have a balance remaining. The North Staffordshire Package has yet to bring forward a proposal to take up its remaining balance of £725k; whilst the Coventry and Nuneaton Package has a project at pipeline stage seeking several times the value the package has remaining. Given the last date for commitment is fast approaching, it is recommended that a deadline is set for the submission of appraisal ready full applications from North Staffordshire and Coventry and Nuneaton packages to bring these packages up to 100% commitment by February 2012.

4.5 The North Black Country Package is forecasting to miss its target this year by some £1.4m, an under-spend of 50%. The other Package Managers have provided forecasts that suggest they will meet their spend targets this year. The forecasts provided by Coventry & Nuneaton and North Staffordshire Packages appear realistic and both are likely to achieve their spend target. The Solihull Package has several large capital projects, and provided these don't experience delays, it should also meet its target. The remaining packages have a significant amount of lost ground to make up. The Birmingham Package is particularly exposed because of its high dependency upon gap funding programmes.

Open Call May 2012

4.6 Modifications to the operational programme earlier this year extended eligibility for Priority 3 funding to other deprived localities outside the package areas. In March, the remaining balance of £7m was made available through an open call for projects from these areas to come forward for consideration. Of the 8 applications submitted, 6 were selected with a value of £9 million. Two of these projects, Silverwoods Enterprise Centre and the Coventry and Warwickshire Gateway, have subsequently withdrawn.

Risks and Demand

4.7 In August, five of the six Package Managers wrote to DCLG setting out a number of projects which they felt could come forward in the event that further funding opportunities were to be provided for Priority 3 funds. A few of these proposals were to extend projects which are already in delivery.

4.8 Whilst it is therefore evident that there is demand for further funding, a number of risks are also apparent. Despite a high commitment level, actual spend in this priority axis remains low. Priority 3 has the highest proportion of land and property projects which are more susceptible to external slippage factors. In some cases, a high proportion of package allocations have been dedicated to gap funding schemes which further exacerbates the risk of slippage. Alongside this, we must also factor in the issues affecting the JESSICA scheme, which at a value of £10m accounts for 12% of the Priority allocation.

4.9 To mitigate these risks, it is advisable to significantly increase the over-programming level of Priority 3. It is therefore recommended that a Priority 3 bidding round is launched in October to establish a reserve list of projects to take up further funding in the event it becomes available through slippage, project withdrawal, clawback or virement. It is recommended that such a call be open for projects to come forward from all package areas as well as all other deprived areas of significant population across the West Midlands, such a call should also be made open to project extensions.

4.10.1 As a result of a formal review of the packages took in 2009 spend targets were established for each Package from 2010 onwards. The spend targets were proportionate to the N+2 target, and in the event that a Package failed to achieve an annual spend target the Package budget allocation was to be reduced by the related amount of under spend. All packages failed to meet spend targets in 2011, and the LMC decided to reduce each Package allocation by the associated deficit. The LMC are asked to consider whether packages which fail to meet their spend target in 2012, should again be reduced by the deficit, or whether this performance instrument may be counter productive at this juncture in the programme, where packages have met full commitment levels, and/or may be bringing forward new projects for consideration through a call. The LMC Subcommittee considered this point, and recommended that going forward slippage is managed at project level.

4.11 However, Packages are currently permitted to recycle grant from withdrawn projects, irregularities or slippage back into their Packages. With the final deadline for programme commitment approaching, there is a strong argument for these funds to be reallocated to those projects with the greatest ability to deliver and spend by December 2015, regardless of location across the eligible areas of the region; and this is the recommendation of the LMC Subcommittee.

5. Priority 4:

5.1 Priority 4 Developing Interregional Activity has been closed to new applications. In March, the financial allocation was reduced from €6,000,000 to €1,046,766 (which was the current euro value of all project commitments within Priority). Due to exchange rate gains and underspend, there is a very small balance remaining of £60k which will be reallocated in the next set of financial modifications, when final claims should have been received.

6. Priority 5: Technical Assistance

6.1 This priority has an allocation of €11.9m (£10.1m) support costs associated with programme management, communication, monitoring, evaluation and other activities which increase capacity to implement the programme effectively.

6.2 This priority has a balance remaining of just over £2m which should be considered for reallocation to other Priorities which will deliver additional impact by December 2015.

7. Summary

7.1 The following summarises the current position of each Priority (£m)

Priority Axes	Current sterling value (£m)	Committed (£m)	Approved subject to contract	Pipeline	Balance remaining
1	123.5	75.3	9.5	13.6	29.4
2	121.1	88.4	8.3	19.2	5.6
3	85.0	50.2	23.1	14.7	-3.1
4	0.89	0.83	0	0	0.06
5	10.1	3.3	0.7	4.1	2.0
Total	**340.7**	**218.1**	**41.6**	**51.7**	**33.9**

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2. Annexes

2.1 The following annexes are attached to this paper:

- Annex i Investment Framework Priority Axis 1
- Annex ii Investment Framework Priority Axis 2
- Annex iii Investment Framework Priority Axis 3
- Annex iv List of projects receiving full approval since April
- Annex v Highlight report on the packages

Paper prepared by: **Anna Vinsen**
ERDF Team Leader

Tom Blackmore and Stuart Brandrick
ERDF Priority Managers

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