Department of Enterprise, Trade and Investment
www.detini.gov.uk

FROM: David Sterling

DATE: 9 August 2011

Copy Distribution List Below

TO: 1. Andrew Crawford
2. Arlene Foster MLA

INVEST NI BUDGET – IN YEAR REDUCED REQUIREMENTS

Issue: Significant reduced requirements have been identified in the Invest NI 2011/12 budget. At this stage it is considered to be too early to judge whether further reduced requirement may arise across the Budget 2011/15 period.

Timing: The next in-year monitoring round is in October 2011. However, under DFP budget guidance departments are required to immediately declare significant reduced requirements.

Need for referral to the Executive. Proposed internal reallocations of £4m would require Executive approval as part of October Monitoring.

Presentational Issues: The Invest NI reduced requirements are likely to attract considerable interest from the business community along with political, trade union, and media interest.

Freedom of Information: It may be possible to claim exemption for this submission as policy under consideration.

Programme for Government /PSA Implications: Revised PFG targets have not been confirmed. Invest NI has provided an assurance that the targets announced for it within the Budget are still achievable.

Financial Implications: The inability of Invest NI to fully utilise its budget this year may make it more difficult to justify funding proposals in future budget exercises.

Legislation Implications: Not Applicable.

Statutory Equality: Not Applicable.

Recommendation: a) That you consider the information below and confirm that you are content that we begin discussions with DFP about the handling of reduced requirements totalling £17.4m (comprising £8.6m Current expenditure and £8.8m Capital expenditure);

b) That you also confirm that you are content for this material to be used to prepare briefing for the ETI Committee;

c) Agree that we should put in place more formal arrangements for monitoring Invest NI's budget performance on a regular basis (to provide assurance to the Finance Minister that you are taking this issue seriously);

d) Agree that we should review with Invest NI the adequacy of current allocations and targets for the last three years of the Budget period; and

e) That you endorse the proposed lines to take.

Background

1. Invest NI was provided with the Budget set out below as a result of the recent Budget 2010 process:-

Table 1 – Invest NI Final Budget 2011-15 Settlement

	2010/11	**2011/12**	**2012/13**	**2013/14**	**2014/15**
Resource	*126.3*	128.8	133.0	125.2	129.7
Capital	*43.3*	56.3	35.3	13.5	8.4
TOTAL	***169.6***	**185.1**	**168.3**	**138.7**	**137.8**

2. Throughout this process, and up until the last couple of months, Invest NI's position has been that it faced a huge "bow-wave" of claims and carry-forward commitments that would crystallise across the Budget 2010 period, and in particular would place immediate and extreme pressures on its 2011/12 budget allocation. The pressures, whilst of less magnitude in the final two years of the Budget were considered to exist across the Budget period.

3. Even at the time of the Budget settlement we noted signs that actual events on the ground did not fully reflect this position.

4. Our main concern was that Invest NI's claims drawdown position was very sluggish in the latter half of 2010/11. Additionally Invest NI's work-in-progress position was historically low. The combination of these two factors did raise concerns within the Department as to whether the scale of the imminent pressures faced within Invest NI was as severe as was being reported. Within the DETI Budget chapter, it was therefore recognised that a major challenge facing Invest NI within the years 2011/12 to 2014/15 would be delivering the business written in the previous period.

5. Given these signs, we have very closely monitored Invest NI's Budget throughout the year to date. In June Monitoring the only adjustment made by Invest NI was the declaration of a £2m Capital reduction caused by additional receipts. At this time in-year spend remained extremely low, and work-in-progress levels also continued to be a major concern.

6. The Department's Finance Team met with the Invest NI team on 20 June to highlight our concerns and ask that Invest NI again review the 2011/12 budgetary requirement.

7. I attach Colin Lewis's note of 28 June that advised you of the Department's concerns at that time (see Annex A).

Issue and Invest NI's rationale for 2011/12 Budget reductions

8. Invest NI has now reverted to the Department proposing a reduction of £18.9m in its 2011/12 budget comprising £12.6m Current expenditure and £6.3m Capital on top of the £2m Capital that it had already declared to the Department in June monitoring.

9. Invest NI has also not ruled out further reductions during this financial year given the current economic climate. It has specifically highlighted risks around a number of capital projects for which it is currently holding Capital budget totalling £14m within the 2011/12 year. Whilst Invest NI has indicated that it is taking all steps to manage the projects it has indicated that there are some uncertainties around timing and amounts of expenditure. The projects concerned are summarised below:-

	£m
Newry/Strabane site development	8.0
Titanic Studio	3.4
Creagh – uncertainty ref tribunal	2.5
Total	**£13.9m**

10. Invest NI's main explanation for the reduced requirements is that market conditions have changed very substantially since February. This change relates to a significant decline in business confidence resulting in the postponement or delay in a number of key projects. This is as a result of companies facing a more difficult set of market circumstances, with the economic recovery being slower than anticipated.

11. As a result, many of the larger companies, against which Invest NI has a potential financial commitment against agreed projects, are proceeding at a slower speed than had been anticipated. Northern Ireland as a whole has seen a much lower level of recovery than the rest of the UK. Invest NI's position is that whilst much of this change has only materialised since the beginning of this financial year, it will inevitably put pressure on future years if the projects eventually proceed to their expected levels of employment or investment. Current turbulence in the world financial markets as a result of

concerns about levels of sovereign debt are likely to reduce investor confidence further, at least in the short term. A summary of the projects/companies involved is provided below:-

Reduction in SFA Profile for 11/12 - Baseline impact

Company Name	Revenue	Capital	Reason for movement
ZST	0	500,000	Project delay. Teething problems with development of Ford's engines as well the Promoter taking ill.
JHE	0	225,000	Project delay. Has been re-profiled to 12/13 and 13/14. Main reasons for the delay are market conditions and the company's difficulties obtaining acceptable finance terms.
Munster Simms	0	1,000,000	Company has reassessed the project which will now not proceed.
Granville Ecopark	0	975,000	Project delayed due to ongoing planning issues.
Linergy	0	1,000,000	The project has not proceeded as yet, the company is due to submit revised plans which may be a material change.
Evron	0	310,000	Delay in the project.
Webtech	326,000	0	The company will not meet it's employment target for this year.
Frylite	0	250,000	Project no longer proceeding.
Firstsource	1,466,700	0	Triggers will not be met in relation to increase of employment in Belfast and transfer of employees to new Coleraine office.
Fujitsu	1,090,000	0	A recruitment freeze at the company resulted in a request to extend the FAA, which has been approved. This has resulted in a reduction in the drawdown in 2011/12.
Teleperformance	855,000	0	Employment levels in Bangor and Newry are not expected to increase in 2011/12
SQS	100,000	0	Employment ramp-up is slower than anticipated.
Allen & Overy	136,000	0	The employment ramp-up, and related claim periods, have been re-aligned.
3PAR	185,000	0	FAA has been amended to enable HP acquisition. This has led to target dates for employment being pushed out by 18 months.
Citi (Operations)	687,500	0	Employment ramp-up is slower than anticipated.
Yell	242,500	0	Earning period has expired and employment is below target.
Total	**5,088,700**	**4,260,000**	

12. Invest NI has also highlighted that over the last twelve months the level of new cases in 'Work in Progress' has been falling resulting in a current year on year reduction of approximately 50%, from £90m to £47m. This reflects the continued depressed levels of economic activity, restrictions in the availability of bank finance, and lower levels of investor confidence. This 50% reduction in work in progress has therefore reduced the forecast level of budget requirements going forward. It is however Invest NI's position that this has had a more limited impact on the amount of budget surrendered for this year.

13. Notwithstanding Invest NI's explanations, and accepting that changing economic conditions have played some role in terms of the reductions, we believe that a substantial element of the 2011/12 reduction was foreseeable and that reduced requirements could have been declared before now. We therefore suggest that we continue to closely monitor Invest NI's budget on your behalf to ensure that Invest NI's overall financial management capabilities are satisfactory. We expect the Finance Minister will require such an assurance from you.

<u>Invest NI analysis of Future Financial Years</u>

14. Given the scale and timing of the Invest NI reduced requirements, we expect DFP will challenge whether Invest NI is currently overprovided across the Budget period in terms of its funding.

15. Invest NI financial modelling of its existing commitments across future years currently indicates that further under-spending across the Budget period would be likely, even if it were to meet the targets set in the recent Budget exercise. It has however highlighted that it is reviewing its high level forecasting model and that the current economic uncertainty around the global economy mean that it is too early to determine the position around its future budgetary requirements. Indeed it believes that there is the potential that if companies were suddenly to react to an upswing by quickly re-instigating investment plans that its Budget could again possibly come under pressure.

16. We suggest that Invest NI undertakes further detailed analysis on the next three financial years with a view to agreement being reached on the position for these years by the end of December.

17. Given the risks around further in-year surrenders, and the uncertainties around Invest NI's future budgetary requirements, we will continue to closely monitor the in-year position with the Invest NI finance team on at least a monthly basis. We will also review the position around the forward budget forecast. Separate briefing will be provided on these matters as required.

Options within the Department to potentially address Invest NI reduced requirements

18. Invest NI has confirmed that it has taken action to try to maximise spend and therefore cannot further increase spending in other areas over and above that already planned in response to the reductions in project implementation.

19. We have also sought input from business areas on spending pressures/proposals across the Department to attempt to offset the reduced requirements identified by Invest NI.

20. Possible pressures/proposals were identified around Titanic Quarter. These included public realm improvements estimated at circa £1m, and currently uncosted potential improvements to the H&W HQ and Drawing Office. We are also currently holding £2.5m from June monitoring while investigating if this funding could be used on potential Titanic Quarter related projects**.** We consider it prudent not to hold any Capital funding around Titanic related projects as:-

    - there is uncertainty about the ability for such projects to be delivered within the current financial year; and,
    - there is also a likelihood of further in-year Capital reductions from within the Invest NI budget

21. NITB has identified a proposal to increase marketing expenditure by £4m (£2m from baseline funding supported by a further £2m EU funding). The NITB pressure is likely to involve them buying marketing services from TIL. These services, or the activities which they generate, would be different from (and additional to) those which TIL undertake with their own resources, and will be akin to the work which TIL undertakes at the behest of and with resources provided by Failte Ireland.

22. TIL is seeking £2m consisting of:-

- £500k to promote golfing;
- up to £500k for co operative marketing; and,
- £1m for 2012 marketing funding.

23. Given the Budget guidelines under which we operate the only way that funding these spending pressures/proposals could be addressed is through proactive action having been taken by Invest NI to consciously reduce expenditure within its budget in order to free up funding for the spending proposal/pressure in question. DFP agreement would be required in advance of October Monitoring for the reallocation to be put forward, and Executive approval would then be required in the Monitoring round itself.

24. If you are content we will discuss the proposals/pressures with DFP and seek its agreement to putting forward these reallocations in October Monitoring.

25. Given the significant reduced requirements that we have within Invest NI there is however no certainty that DFP will agree to this approach, and even then the proposals would be subject to the agreement of the Executive.

26. Discussions are ongoing with DRD about bringing forward the rapid transit project to improve access to the Titanic Quarter with higher quality vehicles through a transfer to DRD of £2m. DRD is still considering if this could be delivered in this financial year. Given the uncertainties around drawdown, and the potential for further Capital easements within the Invest NI budget,

it is recommended that we do not incorporate this transfer as a means of utilising the current reduced requirement position.

Summary of Reductions/Pressures and proposed engagement with DFP

27. The proposed handling of the inputs from Invest NI and other areas of the Department is therefore summarised below:-

	Current £m	**Capital £m**
Invest NI June Monitoring receipts*	-	2.0
DETI June Monitoring demin reduced * Requirements	-	0.5
Invest NI further Reduced Requirements	12.6	6.3
Total Easements	**12.6**	**8.8**
Proactive reallocation for NITB Marketing**	(2.0)	-
Proactive reallocation for TIL Marketing**	(2.0)	-
Residual Reduced Requirements	**8.6**	**8.8**

* Originally being held for potential Titanic related additional Capital expenditure

** Subject to DFP and Executive approval

28. At this stage we would therefore be seeking agreement from DFP that we can proceed to put forward the NITB and TIL proposed reallocations totalling £4m in October Monitoring, and we would immediately declare Invest NI reduced requirements totalling £17.4m (£8.6m Current and £8.8m Capital).

29. We will also highlight to DFP the risk that there could be further reductions in the Invest NI budget as a result of risks within individual Capital projects that have projected expenditure of £14m in the current year. Further risk of reduced demand for Invest NI's Current expenditure Budget will be highlighted as a result of current extreme instability around global financial markets.

30. We will confirm that you are taking a keen personal interest in this and that we will continue to closely monitor the in-year and future years budget position.

<u>**Communications Plan**</u>

31. It is also proposed that a communications plan is drawn up to communicate the revised budgetary position for Invest NI. Proposed agreed lines to take are set out in Annex B.

32. The plan would involve;

- DETI officials meeting with DFP officials to confirm the position as outlined at 27 to 30 above;
- DETI officials meeting the ETI Chairperson to appraise the Committee of the Departments position; and
- Invest NI engaging with key stakeholders and Invest NI staff using the agreed lines to take.

Recommendations

33. It is recommended that you:

a) consider the information below and confirm that you are content that we begin discussions with DFP about the handling of reduced requirement totalling £17.4m (comprising £8.6m current expenditure and £8.8m capital expenditure);

b) confirm that you are content for this material to be used to prepare briefing for the ETI Committee; agree that we should put in place more formal arrangements for monitoring Invest NI's budget performance on a regular basis (to provide assurance to the Finance Minister that you are taking this issue seriously);

c) review with Invest NI the adequacy of current allocation and targets for the last three years of the Budget period;

d) endorse the proposed lines to take; and

e) agree the proposed communication plan

34. I would be happy to discuss.

DAVID STERLING

cc DETI Board
DETI SMT
Bernie Brankin
Alastair Ross

Annex A
Copy Distribution List Below

FROM: **Colin Lewis**

DATE: **28 June 2011**

TO:
1. **Andrew Crawford**
2. **Arlene Foster MLA**

INVEST NI – WORK IN PROGRESS AND IMPLICATIONS FOR EXPENDITURE

Issue:	To provide an update on the current status of Invest NI's work in progress level and its implications for forecast expenditure in 2011/12 and beyond.
Timeframe:	**Routine.**
Need for referral to the Executive	Not applicable.
Presentational	The adequacy, or otherwise, of Invest NI's budget was an issue that attracted media attention during the Budget 2010 process and influenced lobbying for additional resources from various stakeholders, including the Invest NI Board.
Freedom of Information	Partially disclosable. Information in respect of individual companies / clients whose projects are still in negotiation, or have not yet been publicly announced, will be subject to relevant exemptions.
Programme for Government/PSA Implications:	The size of Invest NI's work in progress will have direct impact on its ability to meet investment and job targets.
Financial Implications	The size of Invest N's work in progress is critical to Invest NI's ability to spend its budget going forward.
Legislative Implications	Not applicable

Statutory Equality Implications	The issues raised in this briefing do not raise any Section 75 issues.
Recommendation:	That you note the content of this briefing.

Background

1. In June Monitoring Invest NI offered up Capital investment reduced requirements of £2 million and chose not to submit any Current expenditure bids. This was despite £1 million Current expenditure being available for reallocation and it having previously signalled significant expenditure pressures during the Budget 2010 process; pressures arising mainly from the reported high level of existing financial commitments.

2. In light of this development, and in an effort to better understand its performance prospects for 2011/12, DETI sought additional management information from Invest NI on its financial performance in the year-to-date ("YTD") and in respect of the status of its work in progress level.

3. The June position appeared to be at odds with the signals given by Invest NI during the recent Budget 2010 process, in particular, that the draft settlement was insufficient and that if it was not improved upon it would hold back its performance; a position that was echoed by other stakeholders such as the Business Alliance and the ETI Committee.

4. In the event the Minister was successful in securing additional budget allocations for Invest NI between the draft and final budget positions, most notably additional Capital investment of £13 million (split £5 million in 2011/12 and £8 million in 2012/13), an <u>Invest to Save</u> Current expenditure allocation for the Nitrates issue of £20 million, and a favourable re-profiling of Capital funding earmarked for various Venture Capital and Loan funding initiatives.

Discussion

5. The information now provided paints a less than straight forward picture of the magnitude of its budget pressures. While care is needed in interpreting a snapshot in time, particularly when it is only two months into this financial

year, Invest NI's financial performance in the YTD, and the current level of its work in progress, suggests that there must already be a possibility, if not a likelihood, that it will offer up further, and potentially significant, reduced requirements during the year if corrective action is not taken immediately to prevent this.

6. Reduced requirements, if they were to occur, would then suggest that the Invest NI results for 2011/12, particularly in terms of new investment commitments and jobs promoted, would not be at the same levels as those achieved on an annual basis across the last Programme for Government period. Invest NI has already cautioned against future expectations when announcing its 2010/11 results on 27th June.

7. Key highlights arising from the latest information provided include:

    a) Unallocated Capital investment of £4.4 million, which suggests no obvious immediate Capital pressure in 2011/12 despite the allocation of the additional £5 million as part of the budget settlement;

    b) Total work in progress [proposed financial assistance] continuing to fall, down 12% on the 30 April 2011 position from £46.4 million to £40 million;

    c) Total work in progress [proposed financial assistance] is down 65% on the equivalent point in 2010/11 from circa. £125 million to £40 million;

    d) Total work in progress represents 34% of Invest NI's budget for proposed new offers of assistance in 2011/12 (£117.5 million), whereas the comparative figure at the same point in 2010/11 was nearer 100%;

    e) Short term work-in progress [those projects that have at least received a positive appraisal] is £25.8 million, inclusive of £7.5 million earmarked for the proposed 500-job Bank of New York Mellon project over which there must now be some doubt as to it progressing, at least to the scale originally envisaged, the Financial Assistance Agreement having not yet been accepted by the company despite the required completion date of 31st March 2011 having now past;

f) The volume of grant claims received in May 2011 is the lowest monthly total in any month starting from April 2008;

g) New accepted offers in the YTD are at the lowest level when compared to equivalent periods over the last four years; and

h) Forecast expenditure for the year shows that Invest NI is indicating significant back loading of expenditure with 24% of its budget (£44.7 million) forecast to be expended in the last month (March 2012), despite the problems in budgetary management that were encountered by Invest NI at the end of 2010/11, specifically the need to accrue £54 million in order to meet acceptable budget tolerances.

8. DETI Finance Division staff and I met with Invest NI officials to discuss these issues. They [Invest NI] have acknowledged the position. Indeed they further indicated that they are also seeing some evidence of softening of potential pressures arising from existing financial commitments as businesses increasingly rein back on the implementation of existing business plans, often as a result of difficulties in securing bank finance.

9. I understand that Invest NI is taking steps to rebuild its work in progress level both in local and overseas markets, although DETI is not party to the specific actions being taken.

Recommendation

10. Although it is early in the current financial year, the financial performance information we have seen has led us to have concerns as to Invest NI's ability to spend its budget this year and perhaps next year also. Coming so soon after the completion of the Budget 2010 process, any further significant reduced requirements will be at odds with the Executive's goal to grow the economy and could also be potentially damaging to DETI and Invest NI's credibility given the strong case that was made for additional funding during the Budget 2010 process.

11. I recommend that you raise these issues with the Invest NI Board, seek a meeting to explore them further, and specifically invite the Board to:

    a) Present their assessment of the current status of work in progress and their views on the resultant budgetary position;

    b) Offer you a briefing on their views of the economy and its impact;

    c) Outline the practical steps and actions that are and will be taken to significantly improve the position; and

    d) Present their suggestions as to how we can assist them in this task.

12. I am happy to provide any further information and explanations you might require in considering this issue. In the event that you would wish to pursue this matter with the Board, either as a specific issue or alternatively perhaps as part of a wider discussion on Invest NI's Corporate Plan objectives, I will of course provide a draft letter to the Invest NI Chairman for your consideration.

COLIN LEWIS

cc David Sterling (O/R)
David Thomson
Trevor Cooper
Bernie Brankin
Glynis Aiken

Annex B

Lines to Take

Reason for Invest NI's reduced requirement

- Companies are facing a more difficult set of market circumstances, and the economic recovery has been slower than anticipated.

- There is a significant decline in business confidence resulting in the postponement or delay in a number of key projects.

- Many of the larger companies, where Invest NI has a potential significant level of financial commitment against agreed projects, are proceeding at a much slower speed than planned given the current economic climate.

- Whilst much of this change has only materialised since the beginning of this financial year it could put pressure on future years if the projects eventually proceed to their expected levels of employment or investment.

- The level of new business written by Invest NI has also fallen sharply reflecting the continued depressed levels of economic activity, restrictions in the availability of bank finance, and lower levels of investor confidence. Invest NI is working hard with both indigenous companies and with potential inward investors to secure new investment.

Only if pressed

- Invest NI can not rule out further reductions during this financial year given the current economic climate.

Annex B

What Invest NI is delivering in 2011/12

- Invest NI will continue to target inward investment and promote domestic investment, provide trade support, and support private sector investment in R&D.

- Invest NI through the Short Term Employment Scheme (STES) forecasts that it will create just over a thousand jobs by 31st March 2012.

- Invest NI in conjunction with DEL will deliver the Assured Skills programme which is a tailored support programme primarily targeted at FDI companies aimed at developing the required skills for set-up and expansion.

- Invest NI is also working with DEL to jointly role out a number of schemes to address skills needs in the ICT sector and explore the opportunity to support graduate placements.

- A range of initiatives are being undertaken to increase take up of existing schemes including a range of regional roadshows profiling Invest NIs range of support.

- Support mechanisms are also being tailored within existing schemes to increase take up including;

  - Enhanced support for market research and in-market support.

  - Competition for first time users of R&D.

  - Wider range of eligibility under the Growth Accelerator Programme.

Annex B

Invest NI Future Years

- Whilst there is considerable uncertainty in the economy and difficulties in predicting the future timing and extent of a recovery, it is too early to say that Invest NI's budget allocations over the 2012-15 period will not be required in full.

- In the current year, there has been a delay in many of the investment plans of client companies.

- This delay could push financial commitments into future years.

- Invest NI, as detailed in the 2011-15 Corporate Plan, has ambitious employment and investment targets in line with the overarching priorities set-out in PSA1 and PSA3.

- At this stage, Invest NI remains committed to these targets and is working hard against a very volatile global economic backdrop in delivering these targets.

Only if pressed

- Invest NI is of course currently reviewing the forward forecast position with the Department, and any revised budgetary requirements will be subject to review on an ongoing basis.