WMCA Investment Board

Date	25th April 2022
Report title	Investment Programme – Cost Escalation Commentary
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Report has been considered by	N/A

The WMCA Investment Board is requested to:

1. **note the arrangements to forecast and address cost escalation issues regarding Investment programme projects;**
2. **note the methods available to meet a project cost overrun.**
3. **note the considerations of any decision maker when requested to approve a Change Request.**

1.0 Background

Investment Board have requested a report that sets out how the WMCA addresses potential issues with cost escalation in relation to the Investment Programme projects.

At a time when inflation is running high, labour costs are escalating and there are known issues within the supply chain, the report is timely and necessary.

This report covers the following:

The role of the parties.

Forecasting cost escalation.

Dealing with cost escalation.

It should be noted that due to well documented events, the Investment Programme affordable limit was capped at £801m in November 2019. Then in March 2021, informed by a favourable interest rate environment, WMCA Board agreed to extend the affordable limit to £871m and the available headroom was fully allocated As a result of the decision to allocate the entire affordable amount, it is not possible for the WMCA to fund additional costs of a project, unless existing commitments within the £871m are de-selected or undone.

2.0 The Role of the Parties

The Investment Programme has formally committed £858m of funding for projects that were nearly all defined under the original list presented to HMG when seeking the Devolution settlement. The vast majority of these projects are delivered outside of the WMCA with Accountable Body status for individual projects assumed by the recipient, nearly always the Constituent Metropolitan Local Authority.

The WMCA retain responsibility for the overall Investment Programme and are required to submit information to HMG when required to do so. The formal arrangements require the WMCA to pass 5 yearly Gateway Reviews instructed by DHLUC and involving Treasury.

The grant recipient monitors and evaluates each project and makes the information available to the Monitoring and Evaluation team at the WMCA. This is a requirement under each Funding Agreement, however it will be considered good practice by the Accountable Body in each instance.

The Officers of the WMCA report the status of each project to the monthly meeting of the Investment Board and a dashboard is produced for this purpose.

Monitoring by each Accountable Body will include:

- Progress of the scheme against milestones.
- Progress against financial budget.
- Progress against deliverables i.e. output and outcomes.

Where a project is not performing against any of the above, there is a requirement to consult with the WMCA if this is a material concern. The accountable Body may then be required to submit a Change Request to the WMCA seeking to alter the project.

Change Requests can be approved by the WMCA Officers or may be referred to the Investment Panel for comment before being referred to Investment Board for decision. In some cases the approval will require WMCA Board to make the decision.

As will be noted from the above, where there is concern over cost escalation and this cannot be met by available Investment Programme funding, the Accountable Body is obligated to refer the matter to the WMCA.

3.0 Forecasting Cost Escalation

As noted above there is a requirement for the Accountable Body to monitor a project and report if the budget is not sufficient to meet the requirements of the project and deliver the benefits claimed in the investment approval.

An additional check is performed by the WMCA each quarter when financial claims against the Investment Programme projects are received. Claims breakdown costs against each of the budget lines contained in the Funding Agreement. Where costs have escalated unexpectedly, this results in a discussion with the Accountable Body that may trigger a Change request.

4.0 Dealing with Cost Escalation

Where an Accountable Body has determined that there is a cost escalation there are several routes to resolve this.

In all instances the projects that have received approval will carry a contingency sum. Typically, this sum will be verified as appropriate as part of the assurance process (the Single Assurance Framework is applied to all projects and programmes). This is the first source to consider when meeting the additional costs. Only if this sum is likely to be exhausted by the current situation, or if future likely cost increases will not be met will the Accountable Body need to consider further action.

The second consideration for an Accountable Body is whether they can meet the additional costs of the project. All Funding agreements obligate the Accountable Body to meet the cost overrun themselves.

In the event that the contingency is, or is likely to be exhausted, and there are no additional funds that can be brought to the project, then the Accountable Body must consider the implications for the project. It is likely to be rare that a project cannot be delivered at all because of cost escalation. However, a change may be a preferred conclusion as opposed to cancelling a project and consideration may be given to value engineering the project and this may result in an extension to the existing timescale or a reduction in benefits. If either of these changes are material, then a Change Request must be issued to seek approval of the WMCA.

In some cases the Accountable Body may seek to prioritise certain elements of the project and divert funding from certain budget lines to others, whilst maintaining their obligation to deliver the whole project. This also requires approval from the WMCA through the Single assurance framework process and a decision is required. For example, in the case of Coventry Masterplan, CCC gained approval to reallocate funding to meet a cost overrun for delivery of the station multi-storey car park and diverted funding from a new platform. This was approved by investment Board, however CCC still retain the responsibility of constructing the new platform and delivering the benefits of the whole project.

So, the methods of meeting a cost overrun can be considered as being:

1. Use the project contingency.
2. Accountable Body meets the cost from their own resources or a third party source.
3. A Change request is issued seeking approval to alter the project.

The decision maker receiving a Change Request must consider whether the project has changed substantially so that it is incapable of delivering the benefits that the original decision was based upon and whether this change is significant in terms of whether they should continue to offer support or withdraw it. They should have regard to the amount of money spent to date and whether this would be abortive if the project was stopped. The decision making body should also consider whether to insist that the Accountable Body should meet the cost overrun as they are obligated to do.

The decision should essentially consider whether the project still represents good value for money, whether a change is justifiable and whether the Accountable Body should meet a cost overrun.

With respect to cost escalation against programmes delivered directly by WMCA, WMCA are in a unique position insofar as it does not, as an Authority, have access to long term income streams which it is able to exercise appropriate influence over. Whilst WMCA recognise it is a recipient of significant sums of Government Grant and Gainshare, as an organisation having little discretion over income results in the organisation having limited financial resilience to manage fiscal shocks against its capital plans for the following reasons:

- Investment Programme resources (£871m) are fully committed to deliver projects sponsored by either WMCA or the Local Authorities;
- All Government Grant provided to WMCA is for specific project outcomes and it has little / no discretion about how it may divert those resources towards an alternative outcome;
- The Transport Levy is agreed on an annual basis and now funds mostly core / essential activity leaving little scope to accrue reserves in order to build in a level of protection;
- The marginal reserves which were available have been utilised in managing the fiscal shocks already presented to (and agreed by) Board;
- Those relatively modest funds where WMCA may have some discretion over deployment (i.e. Integrated Transport Block) are again mostly already utilised;
- The potential to raise a Mayoral Precept is subject to political consent which to date, has not been secured in full.

In light of the above, WMCA continually, carefully manage programmes using the principles documented above, but in the event of serious, sustained pressures materialising, WMCA may be required to discuss options with Constituent Authority partners, or look to de-scope other areas of the programme if all other options available to the Combined Authority are not adequate.