WMCA Board

Date	16 December 2022
Report title	Transport for West Midlands Capital Pressures
Portfolio Leads	Transport - Councillor Ian Ward Finance - Councillor Bob Sleigh
Accountable Chief Executive	Laura Shoaf, West Midlands Combined Authority email: laura.shoaf@wmca.org.uk
Accountable Employees	Anne Shaw, Executive Director of Transport for West Midlands email: anne.shaw@tfwm.org.uk Linda Horne, Executive Director of Finance & Business Hub email: linda.horne@wmca.org.uk
The issues covered within this report have been considered by	Mayor & Portfolio Leads Liaison - 18 November 2022 Strategic Leadership Team - 23 November 2022 Strategic Transport Board - 25 November 2022 Strategic Transport Officers Group - 28 November 2022 West Midlands Finance Directors - 1 December 2022

Recommendation(s) for action or decision:

1. Note the extent to which the WMCA Transport Capital Programme has been impacted by cost pressures as documented within this report.

2. Note that in respect of one scheme, the cost control issues have resulted in a breach of financial regulations as detailed in Section 8.

3. The Board is recommended to commission a formal independent investigation through the Authority's Chair of Audit, Risk and Assurance Committee in respect of the scheme referred to in recommendation 2 above.

4. Note the limited funding options open to WMCA to meet these additional pressures as set out in Section 5.

5. Approve the approach towards dealing with the most urgent budgetary pressures detailed in Section 5, including the release of capital funding allocated within the Transforming Cities Fund programme.

6. Note that approval for immediate budget increases to three specific project budgets (totalling up to £17.8m) is requested within the Private Appendix to this report.

7. Approve that, subject to DfT approval and following the WMCA SAF process, a number of projects previously funded by TCF and WMCA Capital Investment programme (as detailed in the separate private report) should subsequently be funded from the CRSTS programme.

8. Note the early warning of further capital pressures as documented within this report.

9. Delegate authority to the Section 151 Officer and Executive Director of TfWM (in consultation with the Mayor and WMCA Portfolio Lead for Transport) to make a formal change control application for the CRSTS programme to the DfT in parallel to the WMCA SAF process, in line with the approach set out in Section 6.

10. Note and accept the risk that in a worst-case scenario where no funding alternatives can be identified or costs avoided, a levy increase or corresponding transport budget savings to the value of circa £11m to £20m would be required to meet the full extent of the capital cost pressures detailed within this report. Any precise Levy increase, should this be required, would be subject to a further report to this Board.

11. Note the work being committed, as outlined in Section 7, to enhance the robustness of management and reporting of capital projects in the WMCA Transport Capital Programme.

1. Purpose

1.1 The purpose of this report is to update the WMCA Board on the current budget pressures being experienced on transport capital projects in delivery, the reasons for these and to advise on potential solutions to ensure that they can be completed successfully within a managed way which prevents any revenue cost exposure to WMCA and the Local Authorities.

1.2 It also considers the impact that the WMCA Board need to be aware of arising from ongoing pressures on capital projects that are under development and heading towards delivery.

2. Background

2.1 The Combined Authority, together with the Local Authorities, have been successful over the years in attracting substantial funding for transport projects. In addition to annual settlements from Government on the integrated transport block, other sources of funding include Local Growth fund via the Local Enterprise Partnerships, Transforming Cities Funds as part of devolution deals, Rail Investment Programmes and other grants, examples including Future Transport Zone, Active Travel, zero emission funds for bus infrastructure and retrofit and other innovation programmes.

2.2 This has enabled the delivery of a number of substantial projects including bus infrastructure, metro extensions, rail enhancements including Perry Barr Station, public realm, cycling infrastructure, road and traffic signal upgrades and innovation projects including CAV testbeds and other sensor technologies. The majority of these have been delivered successfully on time and within budget, many were completed to support the successful transport arrangements for the Commonwealth Games, ensuring that the region delivers on outcomes in relation to sustainable connectivity on the transport system.

2.3 City Regional Sustainable Transport Settlement (CRSTS) has provided further longer-term sustainable funding for WMCA and the Local Authorities enabling the development of a pipeline of further investments on road, rail, bus, active travel, and further innovation such as VLR. A number of projects are now moving forward into the development and delivery stages with some due to be delivered within this 5-year settlement period, and others having their business case developed for delivery in an anticipated second investment period.

3. Budget Pressures

3.1 Over the last couple of years', we have seen a number of projects increase in costs due to scope changes and construction challenges which have emerged on site. It has been possible to manage these costs on a project-by-project basis within existing capital resources. Project teams have consistently responded to cost and scope creep pressures, minimising the WMCA's exposure, applying mitigation through commercial strategies which have avoided prolongation (acceleration and recovery) and achieved more efficient ways of working. Residual cost pressures have then been managed through contingency budget allocations as part of the project risk management and through additional budget allocations, including securing additional external funding all noted or approved by WMCA Board. Despite the residual budget pressures detailed within this report, there are examples which demonstrate WMCA have managed to reduce exposure to more excessive cost escalations through management of scope, negotiations with stakeholders and re-evaluations of delivery methods.

3.2 These kinds of increases are not uncommon in transport projects, particularly in large complex projects where site conditions have thrown up challenges which cannot be found until works start and significant dependencies exist on other projects (affecting programme delivery timelines, scope change requests or cost inflations during the lifetime of the project). Standard practice is to allow for programme and budget contingencies to accommodate these pressures and this has been the case in all TfWM projects. However, the last few years have thrown up a number of extraordinary further challenges, notably in relation to hyperinflation that we are now facing, and which is a national and global issue. The potential scale means that we are unable to contain this within the existing capital resources and are therefore required to take some actions to mitigate any cost exposure to the Authority.

3.3 We are seeing sharp rises in the cost of construction due to national and global events (Brexit, covid, international unrest). The prices and shortage of materials and labour together with rising energy prices is having a major impact on projects in contract and due for completion during 2023. A small practical illustration is that due to metal prices; issues in the raw materials supply chain; and a spike in demand as countries seek to reduce fossil fuel reliance, the cost of electricity sub-stations (which are involved in all our metro and rail projects) have more than tripled in the last 9 months and are taking longer to source. It should also be noted that as we are predicted to enter into a further recession and with interest rates rising this will continue to have an impact for those projects due to complete later in the programme or are in the development pipeline and are yet to enter into construction.

3.4 The construction industry is historically one of the first sectors to be negatively impacted by a change in market conditions brought on by recession and inflation, in the last few years labour shortages and corresponding wage inflation has also been an extraordinary factor. This has been particularly evident given the demands of competing mega projects such as HS2 projects in the West Midlands as well as the various time limited programmes currently underway nationally.

3.5 The worldwide supply chain was slowly recovering following the pandemic, with a steady rise in output and cost somewhat above general inflation levels. Since October 2021 costs have significantly increased for materials and fuels. By way of example, average material costs have risen significantly since this date from a predicted index of 2.5% to 17%.

3.6 These external factors have all added to the financial and / or resource pressure to transport investment programmes. The result is that costs have, and continue to, increase in all transport programmes whilst funding levels remain the same. This is adding greater risk into those projects in flight overspending against budgets agreed and set before a number of these global factors were understood. Therefore, our ability to finish these projects without further budget allocation is also compromised.

3.7 WMCA are not exclusively impacted by the adverse delivery conditions. The Chair of the Chartered Institute of Public Finance Accountants recently reported that the costs of excessive inflation were now causing several Authorities nationally to review and trim their investment programmes, and West Yorkshire Combined Authority recently agreed to pause and move to their pipeline over £200m of CRSTS investments as a result of similar concerns.

4. Impacted projects

4.1 The appendix to this report summarises the projects which are exposed to the issues highlighted and is to be discussed within the private section of the Board meeting so as not to compromise commercially sensitive contractual negotiations. In summary, three inflight schemes will require an immediate uplift in budget totalling £17.8m. In addition to this most immediate issue, there are a number of cost escalation 'early warnings' which are considered highly likely to mature into an actual cost pressure to some degree over the short to medium term.

4.2 The total value of the immediate and early warning matters equates to £171.1m. It is expected this maximum exposure can be mitigated to £85.9m subject to the effectiveness of specific mitigations WMCA intend to deploy.

4.3 The sums outlined above excludes the costs to address the Dudley to Brierley Hill element of the Wednesbury to Brierley Hill Metro extension which will be the subject of a specific report in the February's WMCA Board. This report will address the funding position for the Extension following an earlier report which agreed a number of funding options which would be pursued to support this scheme's delivery in full. Once the Board has determined its preferred way forward for this scheme and further work is completed on the early warnings a fuller picture of total financial pressures can be presented.

5. Cost Pressure Funding Strategy

5.1 WMCA is heavily constrained in terms of the discretion it can exercise over its capital funding. Whilst the overall programme is substantial, many projects are funded on a project specific basis (e.g. ZEBRA / Land Fund) where the funding is for specific outputs, and diverting that funding to other priorities would result in the funding being clawed back. Local decisions around Gainshare (Investment Programme) funds mean that funding is fully allocated with legally binding funding agreements in place.

5.2 Transforming Cities Fund (TCF) is the only pot of funding which was fully devolved to the region for local leaders to make the ultimate investment decisions. Whilst the City Region Sustainable Transport Settlement (CRSTS) is also a devolved pot, DfT and HMT do retain some influence in how the funding is used to deliver clearly documented deliverables and outcomes.

5.3 In light of the above and to ensure WMCA are able to meet its imminent contractual obligations on the three most urgent schemes, it is recommended that TCF allocations of £17.43m which are not contractually committed for projects within that programme are released to cover the immediate budgetary pressure. This funding reallocation can take place with the approval of WMCA Board.

5.4 The delivery of the projects funded through TCF remains a key regional priority for WMCA and is integral to the success of wider transport investment i.e., the Metro extension. To protect the timely delivery of the scheme, WMCA has ensured adequate development and design funding remains assigned to it, which will be met through TfWM's Local Network Improvement Plan funding. Delivery funding is to be secured through the CRSTS programme through a change control request to DfT, discussions being advanced in this regard.

5.5 The approach to using the Transforming Cities Funding detailed above will, it is considered, provide adequate time to consult and seek agreement from DfT to enacting the change control arrangements within the CRSTS programme. This in turn should allow the inclusion of projects funded through TCF for delivery and also some of the wider early warnings of other projects into the CRSTS programme, should these budget risks crystalise into budget issues.

5.6 As such, the recommendations within this report seek to obtain approval from WMCA Board to the release of capital funding allocated to the value of £17.8m within the Transforming Cities Fund and to endorse the subsequent inclusion of the TCF project within the CRSTS programme following consent to do so by DfT.

5.7 In terms of the strategy for the early warnings, as detailed above, WMCA are in advanced discussions with DfT on flexibilities within the CRSTS programme and further details on how WMCA intend to manage the CRSTS programme are detailed below.

5.8 It is important to note that WMCA Financial Regulations will require WMCA Board approval to any budget increase either in excess of 10% and / or those which are unfunded. As such, decisions exceeding these tolerances will not be made without full approval from the Board, and funding decisions within these tolerances will be reported to Board for noting, ensuring full transparency of all funding decisions.

5.9 Recommendations to import costs into CRSTS would only occur where a thorough commercial and technical appraisal has taken place to the satisfaction of the TfWM Executive Director and WMCA Section 151 Officer, which will include an evaluation of alternative delivery methods where appropriate.

5.10 It should be noted that in the event WMCA are unsuccessful in obtaining approval to use CRSTS funding for TCF projects, and the early warnings for projects highlighted in the table crystalise into actual pressures, the only immediately viable funding option would be to fund from borrowing, supported through the WMCA Transport Levy. If the WMCA Board remain committed to the completion of those projects, this would require a maximum additional capital sum of £171.1m to be identified. As detailed within the financial comments below, if funded solely by WMCA borrowing this would require between £11m to £20m of additional funding to be identified annually to meet the capital financing costs. This would be in addition to the current Medium Term Financial Plan estimates. At this point the cost of exit from these schemes has not been appraised, but it is anticipated that with the potential of claw back of other government funding this will far out-way the costs of completion further compounding the issue. This is being analysed to confirm together with an assessment of the impact pausing schemes may have whilst solutions are developed.

6. CRSTS Programme Implications

6.1 In order to accommodate the emerging cost pressures, it is proposed to formally introduce specific schemes into the CRSTS programme, subject to the formal WMCA SAF and DfT change control processes the detail of which is yet to be confirmed by DfT.

6.2 It is proposed that the new schemes entered into the programme would be provisioned for under the CRSTS soft contingency mechanism. This mechanism was agreed by the WMCA Board in January 2022 as part of the overall CRSTS programme approval.

6.3 Under this mechanism, it means that at this stage no schemes that are already within the existing core CRSTS programme would be removed, and none of the associated indicative funding allocations would be reduced. Instead, the financial pressure created by the new schemes being entered into the core programme would be treated as over programming.

6.4 The soft contingency mechanism will ensure that until circa year 3 of the programme the total financial commitments made through the WMCA SAF process will be limited to ensure that a total contingency layer of £100m is always retained.

6.5 As all schemes are progressed it is expected that as well as some negative financial pressures, some schemes currently in the programme will either be delivered under budget; or be delayed; or potentially be proven unviable as the business cases mature.

6.6 In such an event then the associated released budget would be used to off-set the additional cost pressures arising from the entry of the new schemes; and/or to allow schemes from the formal scheme reserve list (already agreed locally and by DfT) to be entered into the core programme.

6.7 If by year 3 of the CRSTS programme all schemes appear to be on track to deliver on-time and to budget, then the soft contingency provision will need to be formally triggered. This means some schemes currently in the programme would be slipped into the next delivery period. Those schemes would be identified at the time based on a full review of the programme and a further WMCA Board report and decision.

6.8 It is proposed that all schemes in the current programme receive sufficient development and design funding to enable them to be ready to deliver. This means in all cases the schemes in the programme will benefit from at least an Outline Business Case level of approval.

7. Project Delivery Governance and Lessons Learned

7.1 The delivery teams have been successful in protecting the authority from compensation events and other risks through commercial and formal risk management arrangements as referred to in para 3.2. However, there are some performance issues (such as managing land acquisitions and CPO's in a timely way to maintain the delivery schedule), and inconsistencies in delivery approach that need to be addressed. Consequently, TfWM is changing the way in which it manages, organises and delivers capital projects. Currently the delivery functions are dispersed across TfWM and sat within modal teams. This creates some discrepancies in management and reporting as well as missing opportunities to integrate designs and delivery across modes and with other scheme promoters. A maturity assessment has been undertaken by Arcadis to review TfWM's capability and capacity with respect to the development and delivery of a portfolio of transport programmes. This has provided TfWM with a baseline and a number of recommendations to improve in this area.

7.2 There has also been a number of lessons learnt from the various programmes to understand where and why issues have occurred. Suggested improvements have been incorporated into other projects and programmes as they come forward.

7.3 The Executive Director for Transport for West Midlands is in the process of reviewing and will soon be consulting with staff on the changes proposed to deliver against these recommendations and improve performance going forward.

7.4 Whilst this will address some areas, it will not necessarily address the impacts of inflation and other external factors that impact on delivery costs. It will however better equip TfWM to manage programmes more effectively, have oversight of a single programme brought together from across the various funding streams, and greater transparency of delivery including better reporting to Transport Delivery Committee which currently has the responsibility to monitor TfWM's performance. This will result in a better set of reporting products and provide greater visibility at a Member and Officer level across the WMCA and its constituent Authorities.

7.5 Any findings and recommendations from the Audit being recommended on the technical breach will also be incorporated into these plans.

7.6 A further independent Internal Audit of TfWM Capital Delivery Management, Risk, Monitoring and Reporting will be commissioned by the Authority Monitoring Officer to inform the recommendations from the above work.

7.7 Additionally, TfWM are working with the DfT's acceleration unit where we are seeing specific challenges in decision making, scope changes and approvals with national partners such as Network Rail. This is aiming to remove some of the risks of working on rail assets, including those illustrated by the interfaces in the metro extension and the various rail packages. The aim is to smooth out the process and get timely and consistent responses from all parts of organisations such as Network Rail that need to be involved in signing off designs and delivery in order to mitigate these risks further.

8. Financial Implications

8.1 The issues regarding cost escalation and the strategies to be deployed to ensure delivery of the projects (which includes thorough commercial and technical challenge, assessing options around scope and delivery, with potential utilisation of devolved Transport grants for any unavoidable cost increases) are documented within the report.

8.2 Whilst WMCA intend to thoroughly exhaust all practical alternatives before budget cover for further cost increases are considered, the Section 151 Officer is obliged to highlight to the Board the full extent of the risk which could crystalise if the delivery environment continues to present unmanageable issues. In a scenario where, the cost exposures arise, WMCA could not identify grant funding to absorb those costs, and the schemes needed to be completed; additional WMCA debt would need to be taken out and met from Transport resources (i.e. additional Levy or savings), as follows:

LEVY IMPACT FROM BUDGET PRESSURES	Un-mitigated Exposure	Mitigated Exposure
Cost Pressure / Exposure As Detailed Within Report	**£171.1m**	**£85.9m**
If Funded by New Levy or Transport Savings:		
Minimim Likely Annual Cost & Levy Impact*	**£11.1m** 9%	**£5.6m** 5%
Maximum Likely Annual Cost & Levy Impact*	**£19.7m** 16%	**£9.9m** 8%

*Subject to the preveiling rate of interest at the time of confirming loans.

8.3 Assuming costs of borrowing remain stable, it is currently anticipated that there would be a requirement for a marginal levy increase of £2m commencing from the 2024/25 financial year, increasing to £11m by 2026/27 (to fund the pre-mitigated impact). Members are reminded that the Transport Levy is funded by population split and that any increase over the annual increase in council tax would impact individual Authority core spending power. The priority is however to seek a solution via the use of the £1bn CRSTS funds. This is not strictly an affordability challenge therefore but one of regional approach to transport investment priority.

Estimated Levy Impact (Value & Timing)		Estimate of Additional Levy Required		
		2024 / 2025	2025 / 2026	2026 / 2027
Total Cost of Finance to the Transport Levy	Pre-mitigated (4% Interest)	£2m	£8m	**£11m**
	Post Mitigation (4% Interest)	£1m	£5m	**£6m**

Note : Values above assume TCF is used to address the imminent impact of the three urgent schemes

8.4 A further update on the overall cost exposure to the complete set of schemes indicating cost overruns will be reported to WMCA Board in early 2023 to ensure full consideration of the implications for the CRSTS programme and aligned to the Boards consideration of the Wednesbury to Brierley Hill Scheme post Dudley.

WMCA Financial Regulations state that; any proposal to increase an approved capital budget by a variance of more than 10% of the existing budget shall require a report to be submitted to the WMCA Board. Variances within these parameters are delegated to the appropriate Chief Officer within the agreed scheme of delegations and will be reported to the WMCA Board in Financial Monitoring Reports. With respect to the three projects where additional funding requirements have been identified, a summary by project is included within the Private Appendix to this report.

8.5 With respect to how the crystallisation of early warning pressures will be reported and approved, decisions regarding adjustments to budgets over 10% will not be made without full approval from the Board, and funding decisions within this tolerance will be reported to Board for noting, ensuring full transparency of all funding decisions and in line with WMCA Financial Regulations.

Financial Breach

8.6 With respect to the Wolverhampton Interchange scheme, the accrued value of works instructed and undertaken has recently exceeded the approved budget. Not only does this indicate a weakness in cost control practices, it also represents a breach of financial regulations.

8.7 The value of the breach as of 16 December 2022 has been calculated as £9.680m and represents actual sums paid in excess of the approved budget, plus estimates for the full extent of WMCA's expected contractual liability under a range of scenarios, including potential abortive costs if the scheme was placed on hold to avoid further exposure to cost. The approved budget for the scheme totals £39.7m and the calculated breach value represents 24.3% of that figure.

8.8 The Mayor of the West Midlands, and The Finance Portfolio Holder and the Chair of Audit Risk and Assurance Committee (ARAC) have been alerted and briefed. The breach was also bought to the attention of the Leaders at the meeting on 21 November 2022. An urgent independent investigation will be undertaken into this specific matter to identify and correct any control failures. The specific findings and points of action will be reported back to ARAC once the investigation has concluded.

9. Legal Implications

9.1 As detailed in Section 8, a project exceeding the approved capital budget by a variance of more than 10% is a breach of the Authority's Financial Regulations, paragraph 3.2. As such, this should have been subject to a Report to Board before such expenditure was incurred. To remedy such a breach, this Report is now bringing the matter to Board's attention with the funding for this additional expenditure having been identified at paragraph 5.3. In addition, it is suggested that there be an investigation commissioned through ARAC as referred to in paragraph 8.8. The findings and points of action will ultimately be reported to ARAC once the investigation has concluded.

9.2 In terms of the overall budget issues identified in this Report, this is being kept under review in accordance with the planned actions as provided for in Section 7, taking into account the lessons learned. A further update will be reported to Board in the new year on the overall cost exposure to the complete set of schemes indicating cost overruns. Any further legal implications will need to be considered at that time.

10. Impact on Delivery of Strategic Transport Plan

10.1 The TCF and CRSTS programmes both make a significant contribution to delivering critical infrastructure required to further the LTP policies. This report only concerns the financing and delivery management of schemes and as all key outcomes and impacts as originally planned are expected to be delivered no implications arise from this report.

11. Equalities Implications

11.1 This report only concerns the financing and delivery management of schemes and as all key outcomes and impacts as originally planned are expected to be delivered no implications arise from this report.

12. Inclusive Growth Implications

12.1 This report only concerns the financing and delivery management of schemes and as all key outcomes and impacts as originally planned are expected to be delivered no implications arise from this report.

13. Geographical Area of Report's Implications

13.1 This report only concerns the financing and delivery management of schemes and as all key outcomes and impacts as originally planned are expected to be delivered no implications arise from this report.

14. Other Implications

14.1 No other implications identified.

15. Schedule of Background Papers

None