

## Edinburgh Tram Project – Status Report (DRAFT Private and Confidential)

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The City of Edinburgh Council

20<sup>th</sup> August 2009

### 1 Purpose of report

- 1.1 The purpose of this report is to update Council on a number of work streams relating to the Edinburgh Tram Project. This includes updated information on: the tram budget and construction programme; the Council's funding strategy; the revision of corporate governance arrangements; the review of the Transport Edinburgh Limited (TEL) Business Plan; and plans to mitigate the impact of tram works in Princes Street during the Edinburgh Festival. The report also seeks Council approval of the **tie Ltd** Business Plan.

### 2 Summary

- 2.1 An update report was provided to the Council meeting of 30 April on the work being undertaken by **tie Ltd** - through their commercial engagement with Bilfinger Siemens CAF (BSC) – to review tram programme base costs, assess programme risks and achieve a revised, commercially agreed programme. Since the last Council report there have been significant changes to the cost range for the project which now mean it is unlikely to be delivered within the available funding envelope. This report provides details of revised programme cost estimates and updated information about the outputs from the Dispute Resolution Process and the Project Management Panel.
- 2.2 In the light of the economic downturn, Council officers have also reviewed how achievable the Council's £45m contribution to the tram project now remains. The review confirms the robustness of the Council's financial modelling assumptions and indicates that the Council can still achieve the required contributions from developers. However, there will be delays in achieving the target level of receipts. Fuller details are contained within the main report.
- 2.3 The planned integration of Bus and Tram was reported to Council on 12 March, 2009. The report described the approach to be taken to re-structure **tie Ltd** and TEL as the first stage of the revised governance arrangements that will be needed to deliver and operate an integrated tram and bus network. Revised operating agreements have been prepared to reflect the new governance arrangements and this report explains the key changes.

- 2.4 At the Council meeting of 30 April, 2009 a request was made for a review of TEL's Business Plan, in light of the economic downturn, to assess the impact of economic changes on future service viability. This report summarises the conclusions of that review.
- 2.5 Following the decision to continue tram construction work in the city centre throughout the Edinburgh Festival, a series of mitigation measures have been developed to mitigate the impact of continuing construction work. The key measures are summarised in this report.
- 2.6 The operating agreement between the Council and **tie Ltd** stipulates the need for **tie Ltd** to prepare an annual business plan setting out the company's activities, costs and funding for approval by the Council. **tie Ltd** has submitted its draft business plan for 2009/10. Details of the plan are summarised in this report. Copies of the full business plan are also available as background papers.

### **3 Main report**

#### **Programme and Costs**

- 3.1 The Tram Update report to Council on 30 April 2009 informed the Council about the work being undertaken between **tie Ltd** and the Infraco contractor to review fully the tram programme and timetable with a view of achieving a revised, commercially agreed programme by the end of June, 2009.
- 3.2 This report also highlighted to members that **tie Ltd** had entered a formal Dispute Resolution Process (DRP) on certain elements of the Infraco contract and explained **tie Ltd**'s engagement, through a Project Management Panel, (PMP) which aimed to create a practical forum to work through any points of operational disagreement between the parties in the most constructive manner possible.
- 3.3 The first practical outcome of this process was an agreement about the rates that BSC were applying for certain works (DRP1). The process also sought to achieve a revised commercial baseline for the tram programme to ensure greater certainty about the timetable for completion of Phase 1a and the revised projected outturn cost.
- 3.4 Mediation on DRP1 was held on 29 May, 2009 where an appropriate solution was reached for both the relevant disputed estimates and more broadly across the works. This solution is consistent with the anticipated liabilities for the specified costs under the contract.
- 3.5 However, although **tie Ltd** has fully supported the mediation process, since the first meeting of PMP the group has meet several times, with very little progress being made.
- 3.6 BSC initially set out their delivery programme and offered a revised version of this on 20 May 2009. **tie Ltd** have responded to both programmes seeking additional information to substantiate the claims, made by BSC, under the terms of the programme contract, that certain works will take longer than

initially anticipated. Workshops between the parties have subsequently taken place with no agreement being reached.

- 3.7 The lack of an agreement about the programme and slow pace of progress on other matters resulted in informal mediation being entered into by **tie Ltd** and BSC on certain broad categories of disagreement covering a number of separate issues. This has produced no significant movement in the areas of disagreement.
- 3.8 Despite the efforts made through the PMP process and informal mediation, BSC have reiterated their demands for additional sums of between £80m to £100m with no clear evidence or justification for these. In addition, they have not ruled out the possibility of future claims.
- 3.9 As a result of the failure to achieve agreement **tie Ltd** sought the approval of the Tram Project Board (TPB) on 8 July, 2009 to pursue a strategy of commencing the formal Disputes Resolution Process (DRP).
- 3.10 Given the lack of a commercially agreed programme, **tie Ltd** have now produced a document setting out their revised view on programme and budget implications.
- 3.11 Council officers have instructed **tie Ltd** to prepare a best, baseline and worst case view of programme and budget implications with confidence levels attributed to each scenario.
- 3.12 tie Ltd's work has highlighted a range of scenarios from a best case final cost for the project of £560m with an open for revenue service date of February 2012 to a worst case scenario in excess of £600m with an open for revenue service date of [xxx 2012]. The Council has begun to prepare contingency planning arrangements given that it now appears that completion of the whole of Phase 1a will exceed the available funding envelope. There are several options that might be taken to deal with such a situation. These range from leasing the rolling stock; or, if necessary, reducing the scope of the programme by truncating the line short of Newhaven.
- 3.13 In the course of reviewing the TEL Business Plan, preliminary work has also been done to assess the impact on TEL's revenues should Phase 1a terminate at Ocean Terminal rather than at Newhaven. The estimated impact is described below. An initial assessment shows the potential saving on capital costs would be [£15m] if Phase 1a were to terminate at Ocean Terminal.
- 3.14 In the event that Phase 1a was truncated, this would also impact on the potential to collect developers' contributions. The current status of the Council's funding strategy is described later in the report. However, it should be noted that any truncation short of Ocean Terminal would mean the Council would be unable to gain contributions from Forth Ports.
- 3.15 Aside from truncation, the other main options for dealing with a prospective budget overrun include:

- Further prudential borrowing, with interest costs funded through the Council's revenue budget or through TEL revenues or future leasing revenues.
- The use of capital funds from the postponement or cancellation of other parts of the Council's capital programme.
- Project Termination [lots of detail required]

3.16 **tie Ltd** is currently tendering for utility diversion works for the stretch of the tram line from Ocean Terminal to Newhaven. Council officers have asked **tie Ltd** not to enter into this contract at this stage, in the event that there may be a need to reduce the scope of the project by truncating the section of the line from Ocean Terminal to Newhaven.

### **Council Funding**

3.17 A report was submitted to Council on 21 December, 2006 explaining the Council's funding strategy. This was subsequently reviewed by DTZ Pida to check that the funding assumptions were robust. A further report was provided to the Council on 20 December, 2007.

3.18 In light of the economic downturn, Council officers recently asked DTZ to undertake a further review given the Council's significant reliance on developer contributions to achieve £25m of the £45m which the Council has committed to fund. The purpose of DTZ's report was to assess whether the Council's strategy for delivering its contribution to the tram project remains competent and achievable. The brief given to DTZ Pida was to:

- review the assumptions underpinning the contributions identified by the Council;
- review the Council's funding model;
- assess the risks associated with each element of the funding stream;
- review the Council's approach in dealing with the various risks including risk management and minimisation; and,
- draw conclusions on the overall funding strategy and approach to risk.

3.19 The main focus of DTZ's work has been on short-to-medium term financing requirements and their impact on project cashflow. However, their work supports the view that there remains scope for new planning applications in future to provide some additional contributions to tram funding

3.20 DTZ has reviewed the Council's financial model. The key assumptions within the model cover the scale and timing of construction outflows, set against the scale and timing of inflows from developers' contributions, capital receipts from land sales, and the costs of borrowing to cover any short-term deficits.

3.21 DTZ conclude that the model is robustly put together and extremely thorough. However, the report does highlight that the Council is facing some elements of

challenge in raising the required finance. There are still risks surrounding specific large scale contributions, in particular from Forth Ports. Given a depressed development market and the consequent challenges to developer contributions a more piecemeal approach is likely to be taken to the development of the Leith Docks area than previously thought.

- 3.22 Developer contributions are currently at a standstill and land values remain depressed which is impacting on the key funding sources. In addition, the Council is constrained in its ability to capitalise on the current availability of cheap long term borrowing.
- 3.23 To address these challenges the Council has taken steps to prepare for the lean period over the next few years by ring fencing £3.2m of developers contributions received to cover interest payments, sale of a windfall site of £2m and by being prudent in the assumptions about the collection of developers contributions in each of the next four years.
- 3.24 The above steps should enable the project to come through the current recession with the expectation that the higher level of contributions will return beyond 2014.
- 3.25 The DTZ report concludes that, despite the economic downturn, the Council can continue to meet its obligations to the tram project, funding loan costs and interest payments through the economic downturn and repaying the capital once developer contributions and capital receipts start flowing once again.
- 3.26 The Council had always planned for developer contributions being realised well beyond the construction of Phase 1a. However, the downturn will require the Council to borrow through the prudential framework and re-pay the borrowed sums once contributions begin to flow again.

### **Governance**

- 3.27 A report on the future integration of tram and bus was presented to Full Council on 12 March 2009. The report sought approval of a two-stage approach in the revised governance arrangements between the Council, **tie Ltd**, TEL and Lothian Buses and gave the Council Chief Executive delegated authority to take the necessary steps to implement this.
- 3.28 The first stage of revised governance centred on the transfer of **tie Ltd**'s shares to TEL. The work required to complete this stage of the process is well underway. However, prior to effecting the transfer new governance agreements will be put into place between **tie Ltd**, TEL and the Council. Some of the proposed changes will require amendments to control mechanisms which were previously approved by the Council. It is therefore appropriate that these changes are highlighted, in full, for Council approval.
- 3.29 In order to streamline reporting and avoid any duplication of work between tie and TEL it is proposed that, as part of the first stage transfer of tie's shares from the Council to TEL, more decision making power should be devolved to TEL and the Tram Project Board ("TPB"). It is proposed that, whilst day to day management of the project will remain with **tie Ltd**, the tie board will be reduced in number and all strategic project decisions will be taken by the TPB.

In summary, it is proposed that the following changes be made to existing arrangements [**Query whether new agreements to be attached/available?**]:

- The existing agreement[s] between **tie Ltd** and the Council will remain in place
- The tie board will be reduced to [ ]
- TPB will be empowered, by TEL, to take all decisions with regard to the project, save for certain matters which will remain reserved to the Council.
- A new tripartite Memorandum of Understanding will be signed to deal with the interplay between the **tie** and TEL operating agreements and also certain ancillary organisational matters.
- The TEL board will be [*include details of constitution etc*].
- There will be no requirement for **tie Ltd** to produce an annual business plan. TEL will include **tie's** operations within its business plan.
- New bonus arrangements will be effected to give the Council proper oversight and control over any bonus payments being made in response to the achievement of previously approved project milestones. In addition it is proposed that no bonuses for senior employees will be payable until the project has been completed and only then if agreed milestones have been achieved.

3.30 The Council previously indicated its desire to exercise tight control over tram project expenditure. To this end, the current TEL operating agreement specifies that all claims over £500,000 have to be approved by Council. In addition there are further controls covering overall project cost and the cost of delays beyond certain thresholds. Given the difficulties with the contractors in recent months, it has become more difficult to exercise these controls, in practice. It is therefore proposed that an amended and more robust control mechanism be adopted. TEL and **tie Ltd** have sought greater flexibility with regard to taking management decisions within the Council approved project funding. However, the Council will need to retain enough control to ensure its previous decisions on budget are adhered to. The current estimate for overall project funding is [**tbc**] (as specified above). Part of this estimate is a risk contingency budget, comprised of a variety of specified risk allowances. It is proposed that TEL should be given full autonomy for necessary management decisions within the overall funding envelope, subject to all items it authorises for payment having been previously specifically identified in the programme budget or sitting within an allocated risk budget. Any expenditure beyond the overall approved budget (or in excess of a specific risk allowance) or delay beyond [**tbc**] would trigger a requirement for further Council approval. As a further control mechanism, the Tram Monitoring Officer, the Council's Head of Transport, will be asked to approve any changes to the composition of the risk contingency or any drawdown on any unallocated risk funds within the overall budget. It is anticipated that this solution will give TEL the managerial flexibility the project needs, whilst enabling the Council to retain a robust degree of control. In addition to the above proposals, the Council would retain decision making powers with regard to any substantial changes to the project from the approved Final Business Case.

### **TEL Business Plan**

- 3.31 Following the Edinburgh Tram report to Council on 30 April a Council motion was presented requesting an update of the TEL Business Plan.
- 3.32 In the intervening period work has been undertaken on a review of the TEL Business Plan and the update includes:
- Lothian Buses 3 year plan up to and including 2011 incorporated into the TEL financial model.
  - Re-calibrated Bus costs using 2009 Lothian Bus forecasts.
  - Patronage forecasts from the 2008 update reduced by 10% in the initial years of tram operations.
  - Tram revenue commencement moved to 2012
  - A prudent approach to operating costs
- 3.33 A number of scenarios have also been introduced to the financial model to take account of areas of sensitivity such as:
- Reduced/no concessionary fares on tram;
  - Truncating the route at Ocean Terminal;
  - Flexing of inflation and yield.
- 3.34 The results of the sensitivity test indicated the following impact:

Test	Assumption	Outcome on early years
Reduced Concessionary Fares reimbursement for tram	-10% (50% yield)	£1m per annum decrease on TEL bottom line
No Concessionary Fares reimbursement for tram	-20% (0% yield)	£1.9m per annum decrease on TEL bottom line
Truncate Route at Ocean Terminal	-3%	£0.4m per annum decrease on TEL bottom line
Inflation	-0.5  +0.5%	£0.3m per annum increase on TEL bottom line  £0.3m per annum decrease on TEL bottom line
Yield	-0.5%	£0.4m decrease on TEL bottom line  £0.4m increase on the TEL

	+0.5%	bottom line
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3.35 [Operating Costs – information awaited from tie]

3.36 The results of the recent review are illustrated in the table below and demonstrate the robustness and profitability of the TEL Business Plan.

TEL Business Plan 2006

FBC December 2007

TEL Business Plan 2009

\*patronage trips based

Tram in Service	Phase 1a + b				Phase 1a + b				Phase 1a + b			
	6/12	8/16	8/16	8/16	6/12	8/16	8/16	8/16	8/16	8/16	8/16	8/16
Tram service pattern												
Year	2012	2016	2021	2031	2012	2016	2021	2031	2012	2016	2021	2031
Total TEL revenues £m	128	168	216	357	128	167	216	356	127	172.5	237.4	408.3
Total TEL operating costs £m	127	157	195	312	126	156	194	312	122.9	148.8	208	372.4
Pre tax operating profit/(loss) £m	1	11	21	45	2	11	22	44	4.1	23.7	29.4	35.9

### Tram Roadworks Mitigation Measures

3.37 On 9 June, 2009 the Policy and Strategy Committee agreed the measures and communications to be implemented to mitigate the impact of the tram construction work in the city during the busy August festival period.

3.38 Following that decision, a series of measures have been implemented to ensure the Festivals can proceed as smoothly as possible in the circumstances. Measures that have been implemented include the following:

- alternative venue for Festival Cavalcade and revised arrangements for the Festival Fireworks;
- production and distribution of a Festival venues map with routes for pedestrians;
- an advertisement campaign at major transport hubs and key gateways to the city;
- improved pedestrian signage and space management around the Mound precinct;
- improve tidiness and refreshed city promotion and information around the construction site.

### tie Business Plan



- 3.39 The operating agreement between the Council and **tie Ltd** requires the company to supply the Council with an annual Business Plan setting out the company's activities, costs and funding for the year. This Business Plan requires approval by the Council.
- 3.40 **tie Ltd** has supplied its draft Business Plan for 2009/10 and this appears as a background paper to this report.
- 3.41 Compared to last year's report, in 2009/10 **tie's** activities will almost exclusively involve delivery of the Tram project. **Tie's** only other significant activities involve continued administration of the One-Ticket, multi operator travel ticket; an ongoing role as Authorised Undertaker in the winding up of the EARL rail project; participation in European commission funded research projects on road user charging issues and intelligent vehicles; and participation in steering group meetings exploring possible cross Forth ferry and hovercraft developments.
- 3.42 In their delivery of the Edinburgh Tram project over the course of 2009/10, **tie Ltd** aim to achieve:
- Commencement of track installation (currently underway in Princes Street);
  - Completion of the MUDFA utilities diversion contract;
  - Lodging of the TRO documents required for the permanent tram operation and for these to have Orders to have been made by the Council;
  - The completion of Design assurance;
  - The completion of all drawings issued for construction (IFC);
  - The completion of all consents and granting of approvals for the Edinburgh Park Viaduct;
  - Princes Street tramway construction complete;
  - A8 Underpass Complete;
  - First tram off-site testing complete, and tram ready for deliver.
- 3.43 On-going engagement with the main tram construction consortium around a commercially agreed programme will determine when these milestones can be expected.
- 3.44 The contractual dispute with the construction consortium earlier this year which preceded the start of work on Princes Street resulted in **tie Ltd** signing a Supplemental Agreement which allowed the work on Princes Street to proceed on a demonstrable cost basis. This has enabled good progress to be made on Princes Street completion of which is scheduled for November 2009. The Supplemental Agreement also established a Project Management Panel (PMP) to address and process all other commercial issues surrounding the contract. Whilst the PMP has allowed greater understanding of the issues that exist, **tie Ltd** anticipate that 2009/10 will see further recourse to the contract's Dispute Resolution Process to resolve formally some of the outstanding issues.
- 3.45 **tie Ltd** are budgeting a total of £153.3m for tram expenditure in 2009/10. This is in addition to cumulative actual expenditure on the project of £234m to 31 March 2009.
- 3.46 Experience gained during the initial closure in October 2008 of the Mound to effect MUDFA works, resulted in the establishment of a new multi-stakeholder

Traffic Management Review Group being chaired by the Tram Monitoring Officer (the Head of Transport). This approach helped achieve the successful implementation of the Princes Street traffic diversions, in early 2009 and this group will consider all remaining major temporary traffic management issues arising from the delivery of Tram.

**4 Financial Implications**

4.1

**5 Environmental Impact**

5.1

**6 Conclusions**

6.1

**7 Recommendations**

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**Director's Name**  
Director of (Dept title but not using "Department")

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Appendices            1

Contact/tel/Email

Wards affected

Single Outcome  
Agreement

Background  
Papers