

Edinburgh Tram – Financial Close and Notification of Contract Award

Policy and Strategy Committee

13 May 2008

1 Purpose of report

- 1.1 This report advises the Policy and Strategy Committee of a changed commercial position in procurement negotiations for the Edinburgh Tram Network (ETN) and seeks approval for me to instruct **tie** Ltd to enter into contracts with the Infraco and Tramco bidders, subject to the satisfactory final conclusion of negotiations.

2 Main report

- 2.1 A report updating the Council on the imminent completion of the contractual negotiations for the ETN was submitted to Council on 1 May 2008. Delegated authority, awarded to me by the Council on 20 December, was refreshed to allow **tie** Ltd to enter into contracts to deliver the ETN, subject to suitable due diligence and provided that any remaining issues were resolved to my satisfaction.
- 2.2 While the contracts are now almost concluded and ready for signature, the final terms differ from those anticipated in my report to the Council on 1 May, with the estimated capital cost for phase 1a now standing at £512m, with a further contingent payment of £3.2m due, if phase 1b is not built, although this remains well within the available funding of £545m.
- 2.3 There is, however, no change to the planned date for commencement of fare paying services in summer 2011.
- 2.4 There have also been some further changes to the commercial position of the consortium, following the publication of previous reports to Council. For this reason, details of the final position will not be released until contract closure is achieved.
- 2.5 Because of the urgency of the commercial considerations, a final decision is required in terms of the recommendations contained in this report with immediate effect to allow an imminent financial close.

Recent Developments

- 2.6 I reported to the Council on 1 May that, during contract negotiations, underlying costs were subject to the conversion of provisional prices to fixed sums, currency fluctuations, inflationary pressures and the transfer of risk to the private sector. The finalisation of the contracts required further amendments for similar reasons.
- 2.7 Since then, **tie** Ltd has continued to work to ensure the competitiveness of the developing contract terms so that these continue to represent best value and are fully aligned with relevant regulations. Offsetting the increase in cost is a range of negotiated improvements in favour of **tie** Ltd and the Council in order to reduce the risk of programme delays and minimise exposure to additional cost pressures, as well as better contractual positions.

Capital Cost and Quantified Risk Allowance

- 2.8 The estimated capital cost of phase 1a, as reported to the Council on 1 May 2008, was £508m, consisting of base costs of £476m and a Quantified Risk Allowance (QRA) of £32m.
- 2.9 Following the introduction by Bilfinger Berger Siemens (BBS) of additional cost pressures late in the due diligence process, **tie** Ltd held negotiations with BBS to substantiate its requests for contract price increases and to seek to limit the increase. To help reduce the risk of programme delays, the price increase agreed will be paid as a series of incentivisation bonuses over the life of the contract, on achievement of specified milestones. This approach should minimise the risk to businesses and residents of Edinburgh of delays to the agreed programme of works. These changes increase costs by £4m to £512m, but have corresponding advantages by further transferring risks to the private sector. In addition, part of the package negotiated entitles BBS to an additional payment of £3.2m, should the Council decide not to construct phase 1b of the tram network.
- 2.10 The combined effect of these changes, therefore, is to increase the estimated project cost of phase 1a to £512m, with a further contingent payment of £3.2m due, if phase 1b is not built.

Benefits of the final deal

- 2.11 In return for the financial amendments, **tie** Ltd has secured a range of improvements to the contract terms and risk profile. Currently, these areas are regarded as highly confidential but, subsequent to contractual close, a more detailed report will be submitted to the Tram Sub-Committee.

Alternatives Considered

- 2.12 The very late increase in contract price is clearly undesirable, although an evaluation of the current proposal concluded that it continues to represent the best option in terms of price, programme and quality. All other options considered would extend the time period for financial close by at least three months and so any potential commercial advantage would be more than offset by inflation, additional procurement costs and **tie**'s own running costs, as well as delaying the commencement of revenue generation from the trams.

3 Financial implications

- 3.1 The estimated final cost for phase 1a of the Edinburgh Tram Network of £512m, with a further contingent payment of £3.2m due, if phase 1b is not built, remains well within the agreed funding envelope of £545m.
- 3.2 While the process to reach Financial Close has been longer than anticipated, the final terms are within 2.8% of the Final Business Case estimate of £498m and 0.8% of the estimated cost reported to the Council on 1 May 2008 (provided that phase 1b is built). It is, therefore, considered that the contract terms continue to represent the best value delivery option.

4 Recommendations

- 4.1 It is recommended that the Policy and Strategy Committee:
- (i) approves the final estimated cost for phase 1a of the Edinburgh Tram Network of £512m, with a further contingent payment of £3.2m due, if phase 1b is not built, all of which is within the funding envelope of £545m;
 - (ii) authorises me to instruct **tie** Ltd to enter into contracts with the Infracore and Tramco bidders, in the context of the recent changes noted in this report;
 - (iii) refreshes my delegated authority to make any final, minor amendments in respect of the contracts;
 - (iv) notes that the Final Business Case v2, which was modified by the Council on 20 December 2007, be further modified to reflect the above position; and
 - (v) notes that, following contract close, a report will be submitted to the Tram Sub-Committee.

Tom Aitchison
Chief Executive

Appendices None

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Wards affected All

Background Papers None