Item 6d

transport initiatives Edinburgh

Tram Procurement and Funding Strategy

Discussion Paper

May 2004

Executive Summary

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Tram Procurement Strategy

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Preliminary note

The purpose of this draft executive summary is to provide the tie Board and stakeholders with an insight into the current tie management thinking on procurement and funding. The intention is to take comment at the Board meeting on 24 May and then to work with all relevant parties, especially CEC and the Executive, to arrive at a firm recommendation and action plan for consideration at the June tie Board meeting.

Executive Summary

transport initiatives Edinburgh (**tie**) are in the process of undertaking an assessment of the options available for the procurement of 'infrastructure', 'tram vehicle' and 'system integration' elements of Tram Network.

The aim of this paper is to outline the progress to date and agree the next steps for submission of a full paper to the June board for approval of the preferred procurement strategy.

The procurement strategy for operator has been successfully delivered with the recent signing of Transdev.

The procurement strategy requires to be designed in tandem with an assessment of the financial case for the project. Accordingly, this paper also addresses the funding requirements and affordability of the project.

Procurement Options

A total of six options have been identified by the Infrastructure Procurement Working Group for the delivery of the tram infrastructure to complement the proposed early operator involvement:

1. **Full Consortia Option** – comprising infrastructure, system integration and tram procurement (excluding operator);

2. **Infrastructure and Integrator Consortia Option** - separate procurement of vehicles – ultimately leading to novation of the vehicle contract into a single consortium responsible for all elements of infrastructure;

3. **Infrastructure Consortium Option** - separate procurement of vehicles and additional control over system integration function – ultimately leading to novation of Contracts into a single consortium;

4. **'Arranged' Joint Venture Option** – seek procurement of a JV entity between vehicle supplier and infrastructure consortium – each providing risk-bearing equity;

5. **Infrastructure Development Partner Option** – incremental approach, based on open book/target costs adopting a partnering approach to procurement; and

6. **Traditional Procurement Option** - **tie** procures separate elements of system without single partner.

The progress to date has been delivered through regular meeting of the Working Group which has reviewed the options in detail and taken into account previous light rail schemes. Additionally the lessons learned and published in the National Audit Office report on "Improving Public Transport in England through Light Rail" have been adopted.

In formulating the criteria and undertaking assessment of procurement options, the Working Group made two assumptions, as follows.

- **Timetable** – the current published aim of having the Tram Network up and running in 2009 was used a guide to the desired timeframe; and

- **Work ahead of Royal Assent** - there will be scope to undertake certain preparatory work (at potentially significant cost) ahead of Royal Assent for the Bills.

A paper on the detailed methodology of the 'procurement group' will be issued in advance of the June Board to facilitate an understanding of the rationale for the preferred procurement route. The current preferred procurement strategy is **Infrastructure and Integrator Consortia (InfraCo)** as this best meets CEC/**tie** overall aims of the project as detailed below.

This procurement option also results in the undertaking third party agreements, 'advance' investigations, detailed design, 'advance' land acquisition, 'advance' utility diversion and separate vehicle procurement to the InfraCo procurement. This route mitigates the following significant scheme risks to the 'main' tram construction works:

- Capital Costs and Delays – Ground Investigation, Utility Diversions, Network Rail, Design Development, Planning Approvals, Archaeological finds, and Land availability

It is recognised that this route increases risks associated with availability of funding that will be examined in the paper to June 2004 Board. In addition the following risks arise from the proposed route and will need to be managed:

- Delays – ability to undertake 'visible' works in advance of Royal Assent, availability of resources, procurement of advisors, market interest, interface management, governance and ability to novate agreements.

The overall aims of the preferred procurement strategy

During the Working Group discussions the following aims were identified:

- Allow commencement of works in advance of main construction, to remove a key constraint on overall programme delivery and affordability;
- Facilitate greater control by CEC/**tie**;
- Develop a public transport tram system to complement the unique setting and character of the city;
- Establish a high quality operating tram as an integrated part of the city's transport system;
- Develop the tram service in a manner which contains the risks associated with the initial design and construction and the subsequent operation within limits that CEC and tie can manage;
- Structure the development of the tram procurement to maximise the value of the funding committed by the Scottish Executive together with additional resources becoming available through the ITI;
- Deliver overall project on time and in budget; and
- Maintain competitive stress through the procurement by generating market interest.

Tram Project Funding Strategy

Planned expenditure is presently disaggregated as follows :

1. DPOF / InfraCo consulting and management work ;
2. Land acquisition;
3. Utility diversion; and
4. System construction (at this stage to include vehicle acquisition)

Further disaggregation and possibly aggregation is under consideration.

Items 1, 2 and 3 are described as Advance Costs, being costs which will require to be incurred prior to the commencement of the main tram construction period. This approach not only supports the programme timetable but also disaggregates the procurement process in an optimal manner. c90% of Advance Costs relate to utility diversion and land acquisition.

If it is necessary to minimise advance costs prior to Royal Assent this may cause a delay in commencement, depending on the Parliamentary timetable. This key issue is under active review.

For financial evaluation purposes, two cases are examined below:

- Capital funding up-front to cover a) Advance Costs ; and b) System Construction (the "up-front" model)
- Advance costs funded up-front, and system construction costs financed through a PFI (the "PFI" model)

The business case evaluation process is in the following stages:

1. Establish capital cost estimates and financial projections in 2003 prices – Bill Financial Statement – addressing the entirety of Lines 1 and 2;
2. Review the up-front model for affordability and reassess;
3. Address sources of funding;
4. Consider truncation if necessary;
5. Prepare revised up-front model;
6. Address PFI option;
7. Compare PFI option to up-front model and assess VFM in context of risk;
8. Conclude on funding structure – up-front or PFI, or more likely a further variation; and
9. Deploy selected funding structure within procurement process.

Interpretation of existing financial models

The upfront model discloses capital cost of the full network at an NPV of £428m, which translates into a funding gap of £75m when operating surplus, life-cycle costs and the grant are factored in.

If the Newbridge shuttle is excluded, the NPV of the gap falls to £22m.

In comparison to a fixed price grant award, this is a valid presentation. However, in funding terms it is necessary to unwind the present value discounting and to utilise indexed numbers which allow for inflation. The equivalent funding gap becomes £210m for the full network, falling to £110m if Newbridge is excluded.

In order to fill the gap, a number of matters are under assessment – property development gains, land contributions, advertising and commercial income. A current conservative assessment puts these at c £30m.

The residual gap, if Newbridge is excluded, would require borrowing of c £80m. Repayments with interest will accumulate to c£150m over 30 years, or £5m pa, from a source yet to be identified.

The PFI model highlights that the incremental cost of funding the project costs (excluding Advance Costs) over a 30-year model would reach c£900m, including some complex taxation and other interactions. Although this sounds a daunting number, it is very largely driven by the long term debt service cost implicit in the PFI structure, with underlying assumptions remaining constant.

The NPV of the truncated network funding gap using the PFI model is £149m, compared to £22m in the upfront model. The differential of £127m is in need of further analysis, but in principle represents the additional PFI driven cost which would need to be justified by risk transfer. If this can be done, the PFI model may emerge as the preferred funding route.

Critical influencing factors

- Extent of grant award
- Availability of congestion charging (CC) funds and if so implications for preferred network
- Impact of EARL on Line 2 economics

Relationship to DPOF funding

The process of developing an affordable network within funding constraints is well-underway. It is important to note that two alternatives have already been fully assessed:

- Line 1 loop in its entirety
- Line 2 to either the Airport or out to Newbridge

Both of these solutions are affordable. **tie** has also started a preliminary view of an alternative network, which combines elements of Lines 1 & 2, but falls short of the full network. Next steps will include further truncation assessment and incorporation of Line 3 into the assessment; and evolving a view on the effect of EARL. These are complex exercises and are unlikely to be fully formed for several months. The outcome will also require to be reflected in 1) a decision on the extent of powers sought within the Bills; and 2) communication of changes against a backdrop of the Public Inquiry and run-up to the Referendum. The newly-appointed operator will have a key role in supporting this process and they will inherit gain/pain sharing arrangements around the final agreed network.

It is clear that affordable system solutions are available. The work now is designed to ensure that the best value solution is defined and then executed.

tie and CEC have established an excellent working and contractual relationship with Transdev. **tie** is in discussion with the Executive and CEC to seek an early agreement on funding of the DPOF contract.

Next Steps

The following next steps have been identified.

- **Achieve agreement on DPOF funding**
- Develop the funding strategy in conjunction with the Council and Scottish Executive for the proposed procurement approach;
- Review the options available for minimising spend in advance of Royal Assent;
- Confirm that funding is available to meet the desired delivery programme with trams operational in 2009;
- Review the risks of 'early' or 'late' running of the Parliamentary process and its impact on the delivery programme and consequential cash-flows;
- Develop individual procurement strategies for tram vehicles, utility diversions, design development and land acquisition;
- Review advisor remits and need for procurement of technical, legal, financial, property and insurance advisors for the scheme;
- Conduct contractor/funder market testing for the preferred route for procurement for the 'infrastructure', 'tram vehicle' and 'system integration' elements of Tram Network through an ongoing PIN process;
- Finalisation of the STAG2 submissions;
- Refinement of financial models;
- CEC consideration of Congestion Charging cash flow utilisation bearing in mind sensitive public inquiry period; and
- **tie** consideration of truncation options, especially Airport / Newbridge but also alternative network configurations.

As part of the overall next steps **tie** is assessing the impact on programme and funding of other options in addition to the current proposal for these options we have identified two costs categories:

- Soft Expenditure –This is the internal **tie** project management costs (including consultants costs); and
- Hard Expenditure – This is the sub-contracting activity directly relating to the Capital Spend on the Network.

The three options are:

A) Soft expenditure pre Royal Assent, Hard expenditure pre Royal Assent (minimised where practical);
B) Soft expenditure pre Royal Assent, Hard expenditure post Royal Assent; and
C) Soft and Hard expenditure post Royal Asset.

The detailed Gantt charts taking into account the effect on timings (to be issued at the Board), which will result in tram operating service in 2009, 2010 and 2011 respectively. The report for the June Board will include detailed budgets for options A, B and C.

Recommendations for Approval

Recommendations is sought that the approach outlined is acceptable in principal, subject to full examination and ratification at the June Board. Further detailed background work will be performed by **tie** in discussion with CEC, Scottish Executive.

Approval is also sought to approach the potential market to get early feed back on the proposed procurement.