

Tram Project
Background paper for Meeting with Scottish Executive
Funding analysis as at 26 November 2003

Background and action required

This paper is an update of the paper provided to the Board on 25.11.03 and is designed as background to the preparation of Estimate of Expense and Financial Statement ("EEFS") to accompany each of Lines 1 and 2 Bills. First drafts of these Statements are also attached.

The paper attached to the end of this paper is a Background Note I intend to send to SE prior to the meeting planned for 10.30 Monday 1st December at Victoria Quay. I will attach the draft EEFS's also to the Executive Briefing Note.

I would appreciate :

1. comments and confirmation that you are happy for the Background Note to go to SE in its present form or make suggested amendments
2. comments on the Draft EEFS documents and especially the wording relating to the funding gap

tie / CEC position

The essence of the Board discussion was :

- We have explored all reasonable avenues and concluded that a substantial unconfirmed funding requirement will remain relative to each of the two Lines. There is a risk, advised by Ian McCullough of BDB, that the Committee of MSPs could regard this as cause for terminating passage of the Bill.
- We will allocate the Executive grant between the two Lines according to capital cost, so that there is no criticism that the Bills are double-counting the grant. We will also make the assumption that Line 1 will take precedence and accordingly the Line 1 costings will include the joint-running section costs ; these will not be included in the Line 2

costings to avoid double-counting of these costs, but the basis will be highlighted in the EEFS narrative.

- There is no scope to revisit the one Bill / two Bills decision, or to defer submission of the Bills pending preparation of a Line configuration which fits with the funding available
- Optimism bias is a contingency driven by Treasury requirements and based on their experience with major capital projects UK-wide. This is correctly included in our economic evaluation but should properly be separated in the funding case. We have a rigorous risk management process which will mitigate the risk implicit in the standard optimism bias application
- We will highlight the flexibility arising from the Newbridge / Airport section
- The Executive appear to want options kept open on funding quantum and structure and the meeting should confirm the wording to be used in this part of the Bill submissions. Advice from the Executive and their blessing on the wording is a key element in avoiding rejection of, or extreme resistance to, the Bills' passage from MSPs based on funding issues
- We believe that the Executive and Ministers are very supportive of the scheme in principle and will want to assist in all reasonable ways with the passage of the Bills. All of this is in an environment of very limited commitment of expenditure, relative to the scale of the projects. This leaves scope for decisions to be taken on network scope limitation in the future if that is required.

Accordingly we agreed to engage with the Executive to agree the wording of the parliamentary submission. Other elements of our position are set out for the Executive in the Background Note below.

This document relates to the Edinburgh Tram (Line One) Bill (SP Bill xxx) as introduced in the Scottish Parliament on xxx 2004

EDINBURGH TRAM (LINE ONE) BILL

ESTIMATE OF EXPENSE AND FINANCIAL STATEMENT

INTRODUCTION

1. This document relates to the Edinburgh Tram (Line One) Bill introduced in the Scottish Parliament on [xxx January] 2004. It has been prepared by Bircham Dyson Bell, Mott MacDonald and Grant Thornton on behalf of the promoters Transport Initiatives Edinburgh and The City of Edinburgh Council to satisfy Rule 9A.2.39(c)(i) of the Parliament's Standing Orders and to assist in an understanding of the background to the Bill. The contents are entirely the responsibility of the promoter and have not been endorsed by the Parliament.

2. The document is divided into three parts, in accordance with the determinations of the Presiding Officer at Annexes E and L of the Parliament's Guidance on Private Bills. The first part sets out estimates of the cost of each element of the project. The second part sets out when these costs are expected to be incurred and what margin of uncertainty there is. The third part sets out estimates of the sources of funding for the project.

RELATIONSHIP WITH THE EDINBURGH TRAM (LINE TWO) BILL

3. *The Edinburgh Tram (Line One) Bill has been submitted to Parliament alongside The Edinburgh Tram (Line Two) Bill, which seeks similar powers for a further Tram project which links with Line One. The promoters regard the Bills as representing two parts of a linked network of tram routes and certain aspects of the two projects are coincident, primarily a shared section of the route from Roseburn to St Andrews' Square in Edinburgh. An independent evaluation of the costs and funding for each Line has been performed. To avoid double-counting of the costs related to the joint-running section, these costs have been included in the costings for Line One in this Statement but have been excluded from the costings included in the equivalent document for Line Two (with explanatory notes highlighting this treatment). The quantum is set out below. Similarly, the [Executive Grant] has been awarded to cover the network, rather than made conditional on a particular configuration. The grant has accordingly been allocated between the two routes to avoid any double-counting of this funding. This allocation (though not the aggregate) may be refined as project costings and funding requirements are finalised through formal procurement.*

ESTIMATED TOTAL COST OF THE PROJECT

4. “We estimate the expense of the works or purposes proposed to be carried out under the above Bill to be as follows:

Estimate of Expense	
<i>Work or purpose</i>	<i>Amount (£)</i>
<i>Preliminary development work</i>	£
	£
	£
	£
	£
	£
	£
Sub total for works	£243,000,000
	£
	£
	£
	£
Sub total for general items	£
<i>Replacement and major refurbishment of equipment</i>	£20,000,000
	£
	£
	£
Sub total for contingencies	£[included above]
GRAND TOTAL	£263,000,000

Notes

All costs are stated in 2003 (Q2) prices. Where appropriate, future cash flows have been discounted using standard HM Treasury methodology to provide net present values as at 2003.

The costs include the full extent of Tram Line One set out in the Bill. A section of Tram Line One is coincident with a section of the tram route for which powers are sought in the Edinburgh Tram (Line Two) Bill. The costs of this section included above are £48,200,000.

The contingency costs included above have been advised to the Promoters by their professional consultants, based on their detailed evaluation of the underlying costs and the remaining project risk. The Promoters operate rigorous risk management

procedures, which have supported the development of the project scope and costs. The costs above do not include the contingency element calculated under [Define source of Treasury driven Optimism Bias] which is designed to accommodate more general contingent risk based on non-project specific factors. Had this component been included in the table above, the total costs would rise by £44,300,000.

ESTIMATE OF TIMESCALES

5. The cost will be incurred over the period [2005-2009], with the bulk of the construction due to take place in [2006-2008]. These dates are provided on the understanding that the Bill takes no longer than [15 months] to be passed by the Parliament. The timing of consideration has a margin of uncertainty of [minus three months to plus nine months]. The period of construction has a margin of uncertainty of [plus or minus one year].

SOURCES OF FUNDING

6. It is estimated that the project detailed in the Estimate of Expense is funded as follows—

Funding statement	
<i>Source of funding</i>	<i>Amount</i>
Scottish Executive preliminary funding	£
Scottish Executive integrated transport fund	£210,000,000 allocated to Line One
<i>Operational surpluses, commercial income and property contributions related to the project</i>	£38,000,000
<i>Funding from other public sector and private sector sources to be developed in due course</i>	£15,000,000
Total	£263,000,000

Notes

All costs are stated in 2003 (Q2) prices. Where appropriate, future cash flows have been discounted using standard HM Treasury methodology to provide net present values as at 2003.

The [Executive Grant] is subject to final Business Case being approved by all parties

Signed

This document relates to the Edinburgh Tram (Line Two) Bill (SP Bill xxx) as introduced in the Scottish Parliament on xxx 2004

EDINBURGH TRAM (LINE TWO) BILL

ESTIMATE OF EXPENSE AND FINANCIAL STATEMENT

INTRODUCTION

1. This document relates to the Edinburgh Tram (Line Two) Bill introduced in the Scottish Parliament on [xxx January] 2004. It has been prepared by Bircham Dyson Bell, Faber Maunsell and Grant Thornton on behalf of the promoters Transport Initiatives Edinburgh and The City of Edinburgh Council to satisfy Rule 9A.2.39(c)(i) of the Parliament's Standing Orders and to assist in an understanding of the background to the Bill. The contents are entirely the responsibility of the promoter and have not been endorsed by the Parliament.
2. The document is divided into three parts, in accordance with the determinations of the Presiding Officer at Annexes E and L of the Parliament's Guidance on Private Bills. The first part sets out estimates of the cost of each element of the project. The second part sets out when these costs are expected to be incurred and what margin of uncertainty there is. The third part sets out estimates of the sources of funding for the project.

RELATIONSHIP WITH THE EDINBURGH TRAM (LINE ONE) BILL

3. *The Edinburgh Tram (Line Two) Bill has been submitted to Parliament alongside The Edinburgh Tram (Line One) Bill, which seeks similar powers for a further Tram project which links with Line Two. The promoters regard the Bills as representing two parts of a linked network of tram routes and certain aspects of the two projects are coincident, primarily a shared section of the route from Roseburn to St Andrews' Square in Edinburgh. An independent evaluation of the costs and funding for each Line has been performed. To avoid double-counting of the costs related to the joint-running section, these costs have been included in the costings for Line One in the Statement supporting the Line One Bill but have been excluded from the costings included in this document. The quantum is set out below. Similarly, the [Executive Grant] has been awarded to cover the network, rather than made conditional on a particular configuration. The grant has accordingly been allocated between the two routes to avoid any double-counting of this funding. This allocation (though not the aggregate) may be refined as project costings and funding requirements are finalised through formal procurement.*

ESTIMATED TOTAL COST OF THE PROJECT

4. “We estimate the expense of the works or purposes proposed to be carried out under the above Bill to be as follows:

Estimate of Expense	
<i>Work or purpose</i>	<i>Amount (£)</i>
<i>Preliminary development work</i>	£
	£
	£
	£
	£
	£
	£
Sub total for works	£236,700,000
	£
	£
	£
	£
Sub total for general items	£
<i>Replacement and major refurbishment of equipment</i>	<i>£23,400,000</i>
	£
	£
	£
Sub total for contingencies	£[Included above]
GRAND TOTAL	£260,100,000

Notes

All costs are stated in 2003 (Q2) prices. Where appropriate, future cash flows have been discounted using standard HM Treasury methodology to provide net present values as at 2003.

The costs include the full extent of Tram Line Two set out in the Bill except the costs related to a section of Tram Line Two which is coincident with a section of the tram route for which powers are sought in the Edinburgh Tram (Line One) Bill. The costs of this section are £48,200,000.

The contingency costs included above have been advised to the Promoters by their professional consultants, based on their detailed evaluation of the underlying costs and the remaining project risk. The Promoters operate rigorous risk management procedures, which have supported the development of the project scope and costs. The costs above do not include the contingency element calculated under [Define source of Treasury driven Optimism Bias] which is designed to accommodate more

general contingent risk based on non-project specific factors. Had this component been included in the table above, the total costs would rise by £42,000,000.

ESTIMATE OF TIMESCALES

5. The cost will be incurred over the period [2005-2009], with the bulk of the construction due to take place in [2006-2008]. These dates are provided on the understanding that the Bill takes no longer than [15 months] to be passed by the Parliament. The timing of consideration has a margin of uncertainty of [minus three months to plus nine months]. The period of construction has a margin of uncertainty of [plus or minus one year].

SOURCES OF FUNDING

6. It is estimated that the project detailed in the Estimate of Expense is funded as follows—

Funding statement	
<i>Source of funding</i>	<i>Amount</i>
Scottish Executive preliminary funding	£
Scottish Executive integrated transport fund	£165,000,000 allocated to Line Two
<i>Operational surpluses, commercial income and property development gains related to the project</i>	£24,700,000
<i>Funding from other public sector and private sector sources to be developed in due course</i>	£70,400,000
Total	£260,100,000

7. *The costs reflected above are on the basis that Line 2 links with both Edinburgh Airport and Newbridge and reflect the powers that are being sought in the Line 2 Bill for that section. In the event that funding for the Newbridge link (£45.3m) was not achieved at the outset, it may be necessary to develop that link as a related but deferred phase.*

Notes

All costs are stated in 2003 (Q2) prices. Where appropriate, future cash flows have been discounted using standard HM Treasury methodology to provide net present values as at 2003.

The [Executive Grant] is subject to final Business Case being approved by all parties

Signed

Edinburgh Tram Project

Background Note on Funding Proposals for Scottish Executive

Position as at 27 November 2003

Purpose and Background

tie has been provided with estimates for all aspects of the costs and revenues for the Tram Project. These remain subject to final revision, but are not now likely to change materially in the period to submission of the Bills. The purpose of this note is to provide background information on the basis of preparation of the Estimate of Expense and Financial Statement (“EEFS”) which will accompany each Bill and to confirm that the proposed description of funding arrangements is acceptable. First drafts of these documents are attached.

There have been a number of important developments since the preparation of the Preliminary Business Case for Edinburgh’s Integrated Transport Initiative which was given Approval in Principle in late 2002. That document presumed utilisation of congestion charging revenues to part-fund the Tram Project and it has since been decided that these must now be demarcated. Treasury rules now require an assessment of project contingency known as Optimism Bias, which has substantially increased the aggregate estimated capital costs (discussed further below). Underlying capital costs have also increased (net) due to finalisation of routes, inflation and better estimation. Similarly, previous assumptions on revenues and operating costs have been refined.

Line 3 has been removed from the assessment altogether and will now depend upon Congestion Charging revenues or other additional funding, but committed and confirmed funding sources do not cover the total funding requirements of the Line 1 and Line 2 Tram Project.

Funding position and assumptions

The table attached illustrates the various scenarios :

- Line 1 standalone
- Line 2 standalone to Newbridge
- Line 2 standalone to Airport only
- Network to Newbridge
- Network to Airport only

Each of Lines 1 and 2 and the Network scenarios have been assessed as generating a positive Benefit / Cost ratio within the STAG 2 analysis. Similarly, each scenario produces a financial operating surplus.

The principle assumptions and structural issues are as follows :

1. From a project perspective, the best NPV is produced by drawing down the entire Executive grant during the construction phase, rather than to create a PFI model. This remains subject to further risk analysis, but is unlikely to change as a conclusion.
2. All costs are stated in 2003 (Q2) prices. Where appropriate, future cash flows have been discounted using standard HM Treasury methodology to provide net present values as at 2003. It should be noted that this does not allow for anticipated price inflation in construction costs, compared to a level of Executive grant which is fixed in 2002 prices.
3. The Executive Grant has been awarded to cover the network, rather than made conditional on a particular configuration. The grant has accordingly been allocated between the two routes to avoid any double-counting of this funding between the two Bills. This allocation (though not the aggregate) may be refined as project costings and funding requirements are finalised through formal procurement.
4. The costs for Line 1 include the full extent of capital costs for the route set out in the Line 1 Bill. A section of Tram Line Two (Roseburn / St Andrews Sq) is coincident with a section of Tram Line One. The costs of this section are £48.2m and have been excluded from the Line 2 costings in the Financial Statement to avoid double-counting. This has been highlighted in that document

5. The costs reflected in the attached table and to be included in the respective EEFSs are on the basis that Line 2 links with both Edinburgh Airport and Newbridge and reflect the total powers that are being sought in the Line 2 Bill. In the event that funding for the Newbridge link (£45.3m) was not achieved at the outset, it may be necessary to develop that link as a related but deferred phase. This position will be recorded in the EEFS.

6. Approximately £86m of the costings represents HM Treasury's new requirement for the inclusion of Optimism Bias (which is a very substantial addition to the contingencies of £47m which have been advised by tie's consultants and which are included in the costings). The additional Optimism Bias component was not a requirement when tie made its Approval in Principle submission in September 2002. Given its position and expertise as a private sector led project management company, it will be tie's intention to manage down successfully the optimism bias element of the costs and accordingly the Estimate of Expense will show total costs as the aggregate excluding this component, although the calculation of Optimism Bias will be disclosed.

On this basis, Line 1 has an unconfirmed funding requirement of £15m. The equivalent figure for Line 2 is £70m ; excluding the Newbridge spur this falls to £15m. When the benefits of network operation are taken into account, the net requirement for the Line 1 and Line 2 (airport) network falls to £13m.

The wording to describe this funding requirement is reflected in the draft EEFS documents attached.