



# SCOTTISH EXECUTIVE

**Enterprise, Transport & Lifelong Learning Department**  
Transport Division 3

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Your ref:  
Our ref:

22 April 2005

Dear Stewart

## EDINBURGH TRAMS: INTERIM OUTLINE BUSINESS CASE

We recognise that there has been a very substantial effort involved in the production of the Interim Outline Business case which we received on Friday 1 April. There has been considerable and positive development of the preliminary financial case and we are grateful that this progress has been delivered in the short time available within the tight business case timescales facing us

Last week, I provided you with advance sight of the complete list of queries that we have received so far regarding the Interim Outline Business Case of 31 March 2005. These were a mix of both high and low level – editing queries and constituted the initial responses from the wider Executive as well as our financial advisers to the Interim Outline Business Case material submitted so far. I know that you have been working in the meantime on further editing and revision of the IOBC material and I trust that the early sight of our comments was helpful in this.

I have now attached a refined view of the key issues that have been raised and on which we require further clarification to enable the identified choices and Outline Business case process to be fully assessed. These are the key issues that we will expect to have more clarity on to allow Ministers a clearer understanding of the overall funding and contractual processes required.

As you know we have arranged for a full meeting with yourself and your advisers here in Victoria Quay at 10.00 hrs on Thursday 28 April. At this meeting we expect to both reach agreement on additional clarification required and by when so that we can maintain progress, not just on the funding and the technicalities of the OBC but also towards a better understanding of the affordable options, both for the Executive and City of Edinburgh.



Meantime it would be helpful if you could set out that part of the £20m or so overall grant funding identified for 2005-06 which will allow the ongoing Parliamentary programme and a detailed advance programme to be delivered.



John Ramsay



what is the best scheme  
 ↳ V form?  
 ↳ Affordability  
 ↳ IOBC can  
 then be  
 properly  
 delivered.

Summary of issues for TIE on Edinburgh Trams

too driven by deadline & not getting it right

	Issue
1	Project structure - What is the right scheme?
1.1	Has any work been done on options for the whole scheme?
1.2	What is TIE's proposal for the Newbridge shuttle? There needs to be a clearer picture of what the impact is of inclusion / exclusion of the shuttle.
1.3	Have you considered options for staggering the development of lines 1 and 2? <ul style="list-style-type: none"> <li>• What would be the economic and financial effects?</li> <li>• How would the procurement work?</li> </ul>
1.4	Have other options been considered for the scheme? Can the decision to pursue light rail still be justified in the light of no congestion charging in Edinburgh?
1.5	What work has been completed to outline an integrated transport approach Have other modal options been looked at as part of the scheme. For instance, ultra light-rail, or guided bus. There appears to be little in the IOBC to explain how this will be achieved / what is being done to achieve it. The effects of all proposals identifying bus services (Lothian Bus services and services run by other operators) and their effect on bus patronage and revenue must be modelled and loss of revenue to bus services must be part of the appraisal.
2	Project affordability - What will the Project cost? (whole life)
2.1	What is the financial impact on the SE under the different procurement options in the IOBC ie. quantum of funding needed, varying risk exposures?
2.2	Is a 10% risk allowance sufficient in the costs? Have your technical advisers considered a range of values?
2.3	The 23% optimism allowance seems quite low. Would a higher number be appropriate? <ul style="list-style-type: none"> <li>• The key distinction in the Mott McDonald study between standard and non-standard projects is whether they are 'greenfield' or 'brownfield'. You suggest this project is standard; is this appropriate?</li> <li>• The Mott McDonald study includes a methodology for assessing optimism bias against its causes. Are your numbers based on a review against this work?</li> <li>• What is your view on the methodology used by Flyvbjerg to assess optimism bias figures for UK transport projects, and in particular light rail?</li> </ul>

Define scheme  
 more detail  
 -  
 affordable  
 if you

Need to see DfF Agreement

Have to come off the fence on Newbridge  
 Structure of 2005 incentives runs against lines - other  
 usual assumptions - need review of that structure.  
 Current contractual structure doesn't support Gov plan to  
 encourage & incentivise integrated public transport.

	<ul style="list-style-type: none"> <li>The Scottish Executive is only supporting one light rail project at present. It may be appropriate to use Flyvbjerg's 80% percentile numbers. What would this increase the 23% level to?</li> </ul>
2.4	Why have you described the results with 23% optimism bias as the most pessimistic?
2.5	You report optimism results for works duration. Have these been taken into account in the financial costs? This could be appropriate for privately financed infrastructure?
2.6	Flyvbjerg emphasises in his research the agent/principal problem, where the agent is not incentivised to report costs or timings accurately. What arrangements do you suggest in this case to minimise the potential problem?
2.7	Revenue risk is shared between the Operator and the public sector. Reports by S&P and others note systemic problems in revenue forecasting. How have you taken account of this?
2.8	A 'jam spread' approach to maintenance and lifecycle costs is quite a simple assumption. Light rail maintenance can be 'lumpy'. Have you considered making more specific assumptions on asset life cycle costs and renewal dates?
2.9	Has the impact on Revenue Support Grant (RSG) of phased capex assumptions been considered? It is not clear that phasing and indexation assumptions have been reviewed. Indeed there is a suggestion that the grant will be indexed up – this should be confirmed (by the Transport Dept),
	<ul style="list-style-type: none"> <li>Current assumptions appear to assume that the £375m is used on day one.</li> </ul>
	<ul style="list-style-type: none"> <li>Also need to confirm the appropriateness of the rate used to calculate the RSG.</li> </ul>
3	<b>Procurement approach - What is the best way to procure the Project?</b>
3.1	<p>What approach delivers the optimum VFM position for the public sector?</p> <p>The IOBC appears to focus on funding routes as the prime criterion for deciding project and procurement structure rather than value for money. A robust process for testing risk transfer and VFM should take place before any decision on procurement approach is taken, as outlined in the Treasury Green Book.</p> <p>Ultimately there needs to be greater clarity on the decision-making process, both to date and how it will work in the future to get to a clear choice that has been robustly tested for VFM and where the affordability picture is clear.</p>
3.2	What is the experience so far of Early Operator Involvement?
3.3	The Design Contract appears to increase public sector involvement, and reduce the risk transfer to the private sector.
	<ul style="list-style-type: none"> <li>Is there a case for limiting the design work to that needed for Royal Assent and the infrastructure competition?</li> </ul>
	<ul style="list-style-type: none"> <li>What are the dangers in the novation procedure?</li> </ul>

By Design?

	<ul style="list-style-type: none"> <li>• <i>Will substantial public sector design affect the accounting treatment for the project?</i></li> </ul>
3.4	There are known issues with rolling stock procurement, especially given the small number of manufacturers.
	<ul style="list-style-type: none"> <li>• <i>How would public sector procurement be financed?</i></li> </ul>
	<ul style="list-style-type: none"> <li>• <i>Does public sector procurement introduce an additional interface - and commissioning risk - for the public sector?</i></li> </ul>
3.5	Early progress on utility works may help scheme delivery.
	<ul style="list-style-type: none"> <li>• <i>Should the UK approach to utilities change?</i></li> </ul>
	<ul style="list-style-type: none"> <li>• <i>Could this be done through the private bill?</i></li> </ul>
	<ul style="list-style-type: none"> <li>• <i>How can risks for utility works be transferred to the private sector?</i></li> </ul>
3.6	What work has been done on risk allocation optimisation? The IOBC currently doesn't contain a risk adjusted quantitative analysis.
	<ul style="list-style-type: none"> <li>• <i>Why is there no differentiation of the costs between options?</i></li> </ul>
	<ul style="list-style-type: none"> <li>• <i>Should risk workshops be held now?</i></li> </ul>
	<ul style="list-style-type: none"> <li>• <i>Is there sufficient risk in the infrastructure contract?</i></li> </ul>
	<ul style="list-style-type: none"> <li>• <i>What are the conclusions from value for money and comparator work?</i></li> </ul>
	<ul style="list-style-type: none"> <li>• <i>What consideration has been made of possible risk-sharing mechanisms eg. revenue risk/reward share?</i></li> </ul>
3.7	Are there other procurement options that could be considered?
4	<b>Financing approach - How should the Project be financed?</b>
4.1	What is the right balance of public and private finance during construction?
4.2	Milestone payments are sometimes used for other DB projects. Why are they seen as being difficult here?
5	<b>Funding issues - How should the Project be funded?</b>
5.1	What is the balance of funding between central and local sources?
5.2	What sensitivity work has been done on the funding numbers, e.g. if costs and revenues change?
	<ul style="list-style-type: none"> <li>• <i>Can the City afford the risks it will carry?</i></li> </ul>
	<ul style="list-style-type: none"> <li>• <i>What risks fall on the Scottish Executive?</i></li> </ul>
5.3	Has the City of Edinburgh considered any of the following funding options.
	<ul style="list-style-type: none"> <li>• <i>Property taxation - for instance as proposed for Crossrail?</i></li> </ul>
	<ul style="list-style-type: none"> <li>• <i>Earmarking, or increasing, revenue from car parking? A workplace car parking levy?</i></li> </ul>

	<ul style="list-style-type: none"> <li>• <i>A revised congestion charge scheme?</i></li> </ul>
5.4	What is the impact of the balance sheet treatment of the scheme on the City and on the Scottish Executive?
5.5	Are there options for Capital and Current Public Expenditure for the Scottish Executive to consider?
5.6	There seems to be an assumption that the funding costs under very different procurement approaches would be the same but this is unlikely. Items such as risk allowances, contingencies, fees, interest costs would differ.
5.7	<p>The Level Playing Field Support fund for Local Authorities is closed and the central funding for the project is not subject to this regime. Therefore, these funding assumptions (utilising a similar approach to the LPFS regime) cannot be assumed without further SE confirmation.</p> <p>There appears to be an overstatement of the level of funding support. The reference to Indexation provision in LPFS award is incorrect – it is a fixed payment, reducing in real terms over time. This impacts on which option has the smallest funding gap.</p>
5.8	Has the impact on Revenue Support Grant (RSG) of phased capex assumptions been considered? It is not clear that phasing and indexation assumptions have been reviewed. Indeed there is a suggestion that the grant will be indexed up – this should be confirmed (by the Transport Dept).
	<ul style="list-style-type: none"> <li>• <i>Current assumptions appear to assume that the £375m is used on day one.</i></li> <li>• <i>Also need to confirm the appropriateness of the rate used to calculate the RSG.</i></li> </ul>
6	<b>Project benefits - What are the longer-term commercial benefits of the Project?</b>
6.1	Does the IOBC demonstrate an overall VFM position on the £375m i.e. will the Project deliver benefits in line with the investment levels?
6.2	How will this Project provide benefits for the whole of Scotland?
7	<b>Documentation issues</b>
7.1	There appears to be a wealth of detailed supporting work referred to or implied throughout. It would be helpful if this were either provided, referred to or clearly identified as work in progress.
8	<b>Project development - What happens next?</b>
8.1	What is the minimum amount of money required to deliver Royal Assent and progress on infrastructure procurement? Greater clarity over what has been spent to date and what is needed to take the Project forward is required.
8.2	What is the profile of spend on utilities and design?
8.3	What is the position on land requirements and planning issues?
8.4	Are there any issues that need to be considered regarding the roles and

structure of the public sector bodies involved?
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| <ul style="list-style-type: none"><li>• SE will have control and influence over TIE and TEL.</li></ul> |
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