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THE CITY OF EDINBURGH COUNCIL

Item no
Report no

DRAFT

Edinburgh Tram Contracts Acceptance

The City of Edinburgh Council

20 December 2007

1 Purpose of report

1.1 To seek approval of Final Business Case version 2 (FBCv2) prepared by **tie** for the Edinburgh Tram Network.

1.2 To seek approval for the award by tie of the contracts for the supply and maintenance of the infrastructure works (Infraco) and tram vehicles (Tramco) subject to a supplementary report on the latest negotiated position.

1.3 To seek approval of the governance arrangements of the Tram through completion of the above contracts, commissioning and commencement of integrated transport operations.

2 Summary

2.1 A detailed report recommending approval of the Tram Final Business Case version 1 was presented to Council on 25 October this year. Negotiations with the preferred bidders have since progressed satisfactorily to the point where we can present the FBCv2. This is materially unchanged from the FBCv1 approved in October in respect of scope, programme, risk allocation and estimated capital cost. This current report summarises progress over the last two months drawing particular attention to developments and issues associated with project risks, project funding and governance arrangements.

2.2 Main Report

Recent Developments

3.1 Detailed negotiations between **tie** and the preferred Infraco contractor, Bilfinger Berger and Siemens (BBS), and the preferred Tramco contractor CAF have progressed satisfactorily with a programmed financial close date of 11 January 2008 and programme contract award on 28 January 2008. Members should note that the Tramco contract will be novated to the Infraco contractor, on contract award, as explained in the October report to Council. These negotiations have encompassed contractual matters such as the novation of the Systems Design Services contract, design matters including detailed aspects related to the Employer Requirements, and risk and contingency allocation.

3.2 **tie** has conducted a concerted negotiation process with BBS ensuring that the overall goals of the City of Edinburgh Council are met.

3.3 The cost estimates for the project reflect adequate provision for evolution as the detailed design is completed in the coming months. The design is completed under the Infraco contract from the point of award of that contract through novation of the System Design Services contract with Parsons Brinckerhoff to Infraco.

Project Governance

3.4 The report to Council of 20th September recommended that Council note the revised funding arrangements for the Tram Project and the implications for the transfer of financial risk to the Council. That report also recommended that the Council instruct the Council Solicitor to conclude Operating Agreements with **tie** and TEL. These draft Operating Agreements have now been completed in collaboration with **tie** and TEL and are included as Appendices 2 and 3 to this report. The former agreement regulates the relationship between the Council and tie with regard to the procurement and delivery of the Tram Project, whilst the latter agreement is aimed at ensuring the integration of the bus and tram networks for Edinburgh.

3.5 The full organisational arrangements now in place to ensure effective governance of the Tram project are summarised in the diagram shown in Appendix 1. Besides confirming the links between Council, the Transport Infrastructure and Environment Committee and the Internal Planning Group, that were first set out in the 20 September report, the diagram depicts the roles of **tie**, TPB, TEL, Council Officers, the contractors and designers of Tram, the Tram operators, and the external advice provided by the Office of Government Commerce (OGC) available post financial close.

The Final Business Case

3.6 FBCv2 is included as a background paper to this report and reflects no material changes since FBCv1 in respect of:

- Scope and functionality of the project
- Overall programme which still reflects tram operations commencing in Q1 2011 for revenue services
- Risks retained by the public sector
- Estimated capital costs which remain consistent with the final business case for Phase 1a (Airport to Newhaven) and for Roseburn to Granton inclusive of allowance for risks retained by the public sector.
- Funding currently available for the project of £545m comprising £500m from the Scottish Government and £45m from CEC.

3.7 The FBC repeats its recommendation of proceeding initially with Phase 1a within the funding of £545m committed to the project. Funding available from the Scottish Government will be 92% of the total cost and capped at £500m (excluding the costs of the new Gogar Station to serve Edinburgh Airport).

4 Financial Implications

4.1 The report to Council in October provided a detailed financial analysis of the Final Business Case, based on the design work completed at that time and upon the firm bids received for tram vehicles and infrastructure. This section reflects upon the financial implications and risks associated with the project in the context of the continuing contractual negotiations with BBS, the Infraco preferred bidder, and the design and value engineering work aimed carried out since October.

Capital Costs

4.2 The contracts for Infraco and Tramco are being negotiated by **tie** through to financial close on 11 January 2008 and award on 28 January 2008, after the cooling off period required by law. The total capital costs of the project also includes utility diversions (under the MUDFA contract), tram vehicle costs, tram maintenance, land compensation costs as outlined below and other project costs.

4.3 The estimated cost for Phase 1a includes an allowance for risk contingency of £49m which equates to 13% of base costs yet to be incurred.

4.4 The scope and functionality of the project is as described in the FBCv2 and is reflected in the Employers Requirements which form the basis of pricing by the Infraco and Tramco preferred bidders. Future inflation risk will be borne by the Infraco and Tramco contractors from the point of award of the contract.

4.5 As explained in the October report the scope of the utilities diversions works may vary under the MUDFA contract. Although this re-measurement contract has fixed rates, the out-turn cost of the MUDFA works may vary – depending on the number and complexity of utilities to be diverted. Tie are finalising third party agreements with some of the utility companies to enable the completion of service diversions. Accordingly as previously reported a higher risk allowance has been included amounting to 20.5% of the risk allowance for Phase 1a. Currently, work is progressing in line with expectations.

4.6 The tram vehicle cost is based on a fixed price bid from the preferred bidder for the construction and delivery of trams. Inflation and exchange rate risk is to be carried by the contractor from the point of award of the contract.

4.7 Land compensation sums will not be known until all claims are made and settled. The estimates are based on valuations provided by the District Valuer and are subject to challenge by landowners. In the event of these claims not be negotiated out such cases would be normally be referred to the Land Tribunal

Funding

4.8 The available funding for the project remains at £545m. £45m of this sum has been committed by the City of Edinburgh Council with the remaining £500m as grant funding from Transport Scotland. The terms of the grant award have been agreed with officials from Transport Scotland. The award letter will confirm the split between the Council's and the Scottish Government's contributions to the project and the annual sums that will be provided by the Scottish Government. The Draft Grant Funding Award letter is provided as a background paper to this report.

4.9 It should be noted that an independent assessment has been made, by DTZ following the Conservative addendum to the motion passed by the Council on the 25th October 2007 on the Council's £45m contribution. This independent assessment confirms the scale of contributions that can be expected. Their report states "*that the Council's tram funding strategy is realistic, based on sound assumptions and achievable within the timescales*". The findings are subject to a separate report within the agenda of the Full Council.

4.10 On 12 December the Planning Committee approved the revised Tram Developer Contribution Guideline. This will allow the Council to borrow against future developers contributions for the tram for up to 20 years after completion of the tram project.

Affordability

4.11 The overall position on affordability, as advised by **tie**, remains unchanged since the report to Council on 25 October. Including risk contingencies, but excluding scope and final design changes, the total cost of Phase 1 is now estimated at £585m. Therefore Phase 1a remains affordable even if all of the identified risks materialise.

4.12 The recommendation of the October report for a phased approach therefore still applies with the option for Phase 1b still open within the Infraco contract up to March 2009. By that date there will much greater certainty on the out-turn costs of the MUDFA contract and any associated and other risks arising from the Infraco contract. The decision for inclusion of Phase 1b into the Infraco contract can therefore be made at any time until March 2009.

Revenue Implications

4.13 There is no change in the position of future revenues from the October 25th report to Council.

CEC Guarantee and Designation of Authority

4.14 A Draft Guarantee Agreement and Designation of Authority between the City of Edinburgh Council and the Infraco contractor BBS has been prepared, with the approval of the Council, and will be required to be executed on behalf of the Council before BBS will agree to sign the Infraco contract. The form of the resolution to be adopted by the Council in this regard is provided at Appendix 4.

4.15 A draft guarantee agreement between the City of Edinburgh Council and the Infraco contractor BBS has been prepared by the Council Solicitor and, with the approval of the Council, will be required to be executed on behalf of the Council before the Infraco contractor will agree to sign the Infraco contract.

Risks

4.16 Active risk management on all aspects of the Tram Project continues with strenuous efforts being made by **tie** to resolve, transfer or mitigate outstanding risks. **tie's** risk management process is fully described in the FBC and has been subject to external audit and verification.

4.17 The allocation of risk will have a significant bearing on the final negotiated price and the final out-turn costs for the project. The procurement strategy aims to minimise risk to works costs by placing risks with those best suited to manage those risks. The detailed contractual apportionment of risk and responsibility between the public and private sector has been a central element of the structured negotiations with the preferred bidder. The negotiations do not indicate that there will be any material deviation from the risk allocations described in the FBC.

4.18 A critical third party approval relates to agreement with Network Rail and access to their land. Early works within the construction phase of the contract requires access to Network Rail land if these agreements are not in place work in these areas cannot commence. Negotiations are on going with Network Rail and the lease is in agreed form although cannot be signed until the Asset Protection Agreement is signed with Network Rail.

4.19 The risks retained by the public sector and which therefore bear upon the Council are explained in the Final Business Case section 11 ("Risks Retained by the Public Sector"). Typically this includes agreements with third parties delays to utility diversions and finalisation of technical and prior approvals.

4.20 The risk contingency included in the cost estimates is designed to cover additional unforeseen costs, but it is recognised that there is always an element of residual risk of costs exceeding current estimates. It should be noted that the cost of phase 1a (with a risk contingency of £49m). The headroom provided by the total funding of up to £545m gives a significant additional level of comfort that the project can be delivered within this level of funding.

4.21 There is no change in the position of future revenues from the October 25th report to Council. It should be noted however that the issue of concessionary fares being applicable to Tram, as they are at present to buses, has not yet been finally resolved, because the national concessionary fare scheme is under review by Scottish Government.

4.22 It should be noted that the cost of phase 1a has a risk contingency of £49m. This represents a total contingency sum (risk and headroom) of £96m, compared to £220m of estimated outstanding costs (excluding fixed costs and costs already incurred).

4.23 It should also be noted that the risk contingency does not cover major changes to scope especially to areas out with the immediate Tram corridors. The scope of such changes will be reviewed after completion of the Tram works and commencement of Tram operations.

4.24 Additional scope elements that will separately funded include

- Bermard Street urban streetscape (funded from Scottish Enterprise Edinburgh and Lothian and the Heritage Lottery Fund)
- Leith Walk- completion of footways as betterment with £2m funding from CEC spread over 3 financial years)
- St Andrew Square- on-street capital works - (optional with £6m funding from SEEL and City's Growth Fund)

Next Steps

4.25 The table below summarises the milestone events in the final stages of the procurement and construction of the Edinburgh Tram Network.

- Date	Milestone
11th January 2008	Financial Close.

28th January 2008	Tramco/Infraco contracts awarded following CEC/TS approval and cooling off period.
1st February 2008	Construction commences - phase 1a.
6th February 2008	Planning Committee approval of Landscape Habitat Management Plan.
31st March 2009	Latest decision to instruct *tie*/BBS to commence 1b
17th November 2009	TRO process complete.
27th August 2010	Commencement of test running - phase 1a.
Q1 2011	Operations commence

5 Conclusions

5.1 Contractual negotiations with the preferred bidders for Infraco and Tramco have been progressed satisfactorily by **tie**.

5.2 The preferred bidder negotiations, in terms of price, scope, design, and risk apportionment, give further assurance that Phase 1a can be completed within the available funding and are consistent with the Final Business Case.

5.3 The total forecast project cost including the price, being negotiated by **tie**, is consistent with business case. **tie** is confident that risk contingencies and final the approved design can be accommodated within the funding available.

5.4 A decision on whether to proceed with Phase 1b, within the Infraco contract, can be made at any time until March 2009.

5.5 A Supplementary Report may be issued for the 20 December 2007 Full Council setting out the latest negotiated position with the Infraco contractor (BBS).

6 Recommendations

6.1 To approve the Final Business Case version 2.

6.2 To authorise **tie** to enter into contracts with the Infraco bidder (BBS) and Tramco bidder CAF, (subject to compliance with the Final Business Case and Employer's Requirements and the Supplementary Report to Council on the latest negotiated position) as reflected in the draft resolution in Appendix 4.

6.3 To note that the formal award of these contracts are programmed to take place in January 2008.

6.4 Approve the issue of the Guarantee and Designated Authority by the Council to the Infraco bidder as reflected in the draft resolution at Appendix 4.

6.5 To accept the terms of the Draft Grant Award Letter.

6.6 To approve the draft **tie** and TEL Operating Agreements and instruct the Council Solicitor to sign these agreements on behalf of the Council.

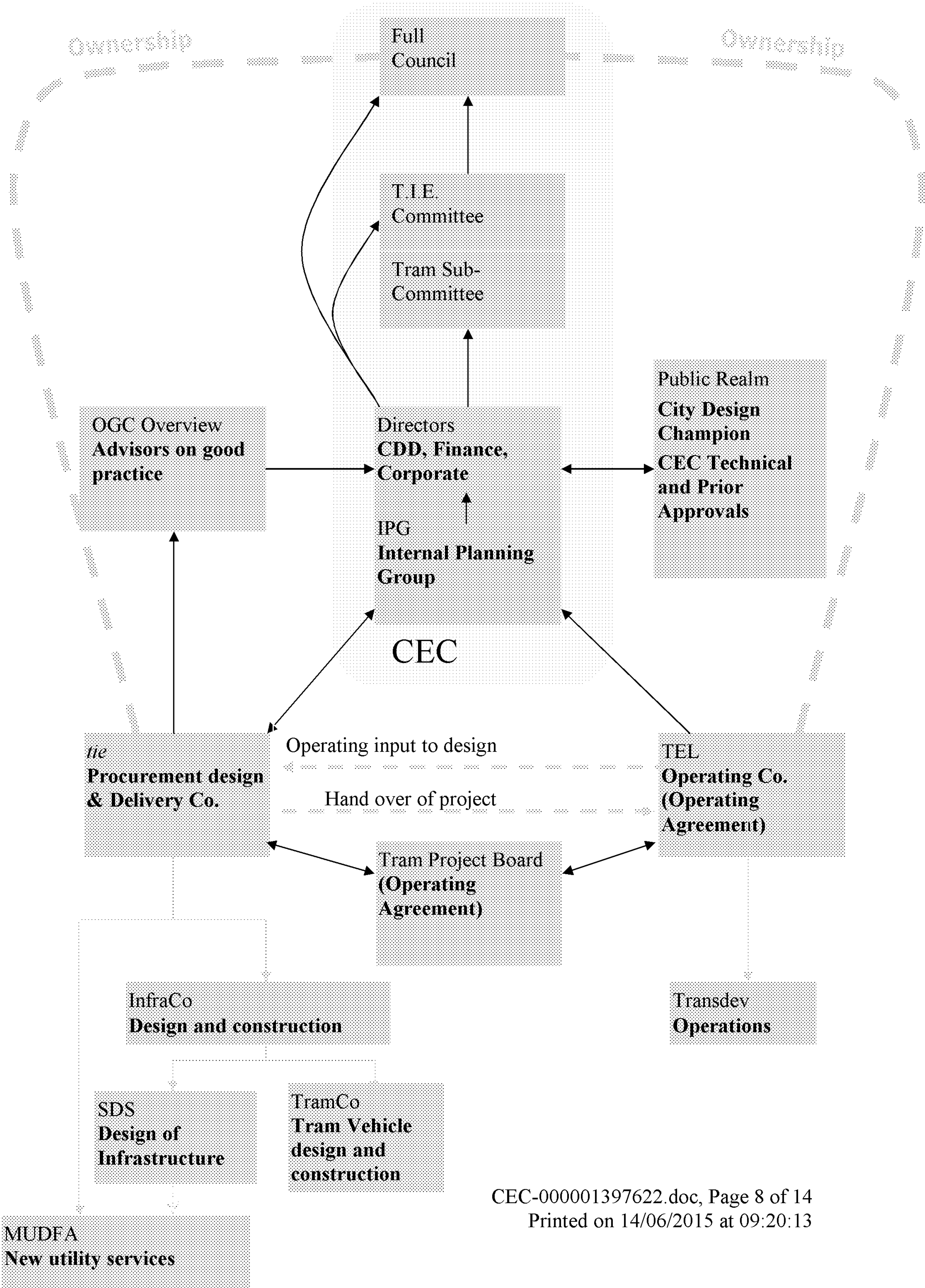
6.7 To note the schedule of milestones presented at Section 4.26 above.

Donald McGougan
Director of Finance

Andrew Holmes
Director of City Development

Appendices	**Appendix 1** Tram Governance Organogram **Appendix 2** Draft TEL Operating Agreement **Appendix 3** Draft tie Ltd Operating Agreement **Appendix 4** CEC Guarantee
Contact/tel	Duncan Fraser Rebecca Andrew [redacted]
Wards affected	All
Background Papers	Edinburgh Tram Final Business Case Version 2 Draft Grant Funding Award Letter

Appendix 1 Tram Organisational Structure



Appendix 2 Draft TEL Operating Agreement

Appendix 3 Draft tie Operating Agreement

Appendix 4

CEC Guarantee

Resolution

- The Council Resolves:

CEC Delegation of Authority

- The Council Resolves

The risks fall into the following broad categories

a Project Risks (risks affecting the timeous completion of the project within time and budget and to the desired quality)
b Operational Risks (risks affecting the long-term viability of TEL)

Project Risks

1. Between now and financial close there is a risk that the preferred bidder may withdraw from negotiations for a number of reasons, including the potential refusal to accept a novated contract for SDS or Tramco. Tie are working to minimise this risk through negotiations with the final bidder prior to Financial Close.

2. The most significant risks affecting the timeous completion of the project within budget are identified in the FBC as those arising from the advance utility diversion works (MUDFA); changes to project scope or specification; and obtaining consents and approvals.

3. The main risk in respect of utilities is that delays from MUDFA in handing over sites to the infrastructure contractor could lead to claims from the infrastructure contractor and significant additional costs. tie staff are working to minimise this risk by working with both Infraco and MUDFA on their respective programmes. There is a further risk regarding the interface between MUDFA and the Scottish Utilities Companies (SUCS). If SUCs fail to approve designs on time, this could delay MUDFA works, which in turn could delay Infraco, leading to claims.
4. The Infraco contract is substantially a fixed price contract, so any scope changes post financial close will have to be implemented using a variation order, which will add costs to the project. It is therefore important that changes are kept to a minimum and to that end; the Tram Project has a clearly defined tight change control procedures, supervised by the Tram Project Board.
5. It is recognised that designs are not yet complete and some design assumptions may prove to be different to the aspirations of CEC and / or other third parties (e.g. Forth Ports). If the designs are built into the contract at contract close and the decision is made to change them at a later date, this will lead to additional costs and potential delay. In order to reduce this risk, further work will be done on the tram designs prior to contract close in the context of available funding.
6. Linked to this risk is that the visual aspects of the designs do not represent the preferences of the prior approvers so that Planning Approval is not given and designs have to be reworked and a variation order made to the contract leading again to additional cost and delay. The planning prior approvals programme is expected to be complete by March 2008, which is post contract close. To minimise the risk of planning approval being withheld post contract close, SDS and tie are involving planning staff in the design process so that concerns can be addressed at an early stage.
7. As noted in paragraph **Error! Reference source not found.Error! Reference source not found.** Value Engineering savings have been built into the cost estimates. If these cannot be achieved, there is a risk

to the project estimate. To reduce this risk, further work will be done on Value Engineering prior to contract close, to improve the robustness of the VE savings. This will be considered prior to Contract Award taking account of the available contingencies and allowances for unrealised risk at that time.

8. TRO hearing is mandatory requirement under current legislation and financial allowance has been made for this under the risk register. It should be noted that the Scottish Government is consulting on potential changes to the legislation, which if approved would remove the mandatory requirement to hold a hearing, where a project has been subject of Parliamentary Approval.

9. As noted in the Report to Council in December 2006 that , on the recommendation of tie that the Council is taking a long lease of land rather than outright compulsory purchase on two sites, one owned by Network Rail the other by BAA. There is a small risk that these landowners may seek to impose conditions on the operation of Tram at some future date.

10. It should also be recognised that any decision by the Council or Scottish Ministers to cancel the trams is not free from costs, as costs including compensation to contractors and redundancies at tie, it is estimated this could be between £20m/£40m (dependent on the timing of cancellation) . Transport Scotland has also indicated that should the Council cancel the tram for other than purely commercial reasons, the Council would be liable for the full cost of that decision. Conversely, should Scottish Ministers cancel the project for similar reasons it is assumed that they would pay for the project termination costs. Transport Scotland have acknowledged this in discussions.

11. The £545m of approved funding also is not completely free of risk. In particular contributions to Tram from developers are of course subject to development activity. However Agreements under Section 75 of the Town and Country Planning (Scotland) Act total some £6.77m to date, with a number of further major contributions in the pipeline.

12. It should also be noted that since tie has no assets the Council will be called upon to give some form of formal guarantee of tie's contractual obligations. Current indications are that both Infraco bidders will be seeking a letter of undertaking from the Council to the effect that subject to final approval of release to the Council of grant funding by the Scottish Government, tie will be fully funded by the Council in respect of all payment obligations and financial liabilities incurred by tie pursuant to the Infraco contract, subject to compliance by the contractor with the contract terms. The undertaking would constitute a guarantee of payment only and not a commitment by the Council as to performance of the contractual obligations.

Operational Risks

13. Future risks arising from the forecasting process have been examined by the JRC. After recapping on the central or reference case forecasts and the assumptions in these forecasts the Revenue and Risk Report tests the sensitivity of Tram to alternative planning and growth assumptions. The JRC also tested assumptions on the attractiveness of Tram to potential users and on the possible impact of bus competition. The analysis of the JRC illustrates the sensitivity of Tram to development assumptions. The interdependence of Tram and development – especially in north Edinburgh should be noted.

14. A detailed statistical analysis has also been carried out that allows the assessment of the impact of a variety of relevant factors within assumed ranges. The analysis notes the sensitivity of the FBC financial projections for TEL. It also re-emphasises the fundamental relationship between the Tram and the continued growth of the City and associated movement demand, and consequently the sensitivity of Tram revenues to planning and economic growth.

15. In mitigation, it should be noted that Lothian Buses' extensive knowledge of the local transport market has been used to inform and validate the modelling process. Passenger growth assumptions are significantly lower than growth Lothian Buses has experienced in recent years.

16. While Council policy can influence planning and economic development there are decisions in the power of the Council and TEL which have a bearing on the outcome for Tram. In this regard the JRC examined the impact of partial completion of Phase 1, the effect of the Edinburgh Airport Rail Link (EARL) and of various detailed operational factors such as the quality of interchange, tram run-times, and bus service integration plans. The recent decision of Parliament to shelve EARL and the associate proposals for a new station at Gogar have not been included in the financial analysis for the FBC but will be positive.

17. The JRC concludes that the most significant risk to Tram arises from the planning growth assumptions (this applies especially to Phase 1b) but that TEL could manage its operations and reduce costs in response. However the most recent data available shows a continuing strong growth in development in areas close to the route of the Tram in north Edinburgh. The highest growth rates in the number of dwellings the City are to be found in Leith and Leith Walk where growth rates of approximately 8% from 2003 to 2005 have be recorded (Source Scottish Neighbourhood Statistics). Confidence can also be drawn from the continued growth in Lothian Buses patronage levels which continues at around 5% per annum – a figure well above the projections of the JRC report.

18. It also should be noted that current modelling assumes that the Edinburgh Tram Project will be covered by the Scottish Executive's Transport Scotland's national concessionary travel scheme. It is a fundamental assumption that has consistently been understood and endorsed by Transport Scotland for business planning purposes that TEL bus and tram will both participate in the national concessionary travel scheme. However, this concessionary travel scheme will be reviewed by Government prior to the commencement of the tram. There is a risk that either the scheme will no longer apply (or provide a lower rate of compensation to transport operators), or that it could apply to bus and not tram. Given the long-standing commitment to integrated operation it is difficult to understand how this would be feasible.