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To: Hugh Dunn, David Robertson, Karen Kelly  
Cc: Donald McGougan

## **Tram briefing – 2<sup>nd</sup> May 2007**

### **Introduction**

This paper is intended to give you an update on the main issues/workstreams associated with the tram project. Please get in touch if you require more detail.

### **Funding Agreement with TS**

Following an initial meeting on 19<sup>th</sup> March, Transport Scotland issued a draft agreement based on one already in existence. The agreement is incomplete and does not cover key issues of concern to CEC, namely –

- What happens in the case of a cost over-run?
- What is the process for approving phase 1b?
- Agreement over the exact amount of the TS contribution (TS are committed to £375m plus indexation for 2002 to outturn prices, but there is disagreement over the exact amount)
- Funding for any costs that fall to CEC from granting indemnities/guarantees to tie
- The extension of the national concessionary travel scheme to tram

A second meeting scheduled for 30<sup>th</sup> April has been cancelled and we are awaiting Transport Scotland to arrange a date to progress matters. It is important that a Funding Agreement is in place well in advance of Financial Close, as CEC cannot sign off the Final Business Case without it.

### **Council £45m Contribution**

As you are aware, the Council's contribution is to be made up from a variety of sources. The latest position is detailed below

- **CEC Cash - £2.5m** - £1m paid in 05/06 and £1.5m is in the approved CIP for 2007-10
- **CEC Land - £6.2m** – To be transferred in 07/08
- **Developers Land Contributions - £2.2m** - £1m for 1a can be transferred in 07/08. £1.1m for 1b will only be transferred when 1b goes ahead (if 1b does not happen, then the Council will have to find an additional £1.2m).
- **Developers Cash Contributions - £24.4m** – This is the most significant contribution stream, and is dependent on the extent and pace of development. Legal advice has been received which states that the Council can continue to collect Developers contributions after the tram is operational, provided it can be demonstrated that contributions are being used to repay borrowing costs. Planning staff have produced estimates of likely contributions receivable over the long-term and this will be used to develop a prudential business case, to assess how much the Council may borrow. The most significant anticipated contribution (£18m from Forth Ports for Leith Docks), requires careful negotiation and the Tram Contributions Group, chaired by Keith Anderson is considering how best to approach this. It should be noted that Developers

Contributions have significant risk attached, as they are linked to the performance of the local economy and may also be affected by legislative changes (eg Planning Gain Supplement)

- **Capital Receipts - £9.7m** – This is a balancing figure to bring the total to £45m. So far no receipts have been identified (previous list circulated was the Council land contribution). This is something which should be raised at the Corporate Asset Management Group as there is a risk that either the tram or the main CIP will be short of funding.

### **Update on Major Contracts**

#### **MUDFA (Multi Utilities Diversion Framework Agreement)**

The most concerning issue here is the delay in programme (now expected to be 5 months beyond original duration (11 months if 1b is to be undertaken). Colleagues in City Development suspect that there will be costs implications associated with this delay. In addition there is a risk of finding (and having to divert) additional services (9 additional services have been found in the test site). **tie** have built in a large risk contingency for the finding of additional services, but we need them to reevaluate whether this is sufficient.

**tie** gave a presentation on MUDFA to the April Tram Project Board, in which they indicated minimal additional costs associated with the delays, which could be mitigated by employing MacAlpine (the contractor on MUDFA) on packages of advanced infrastructure works. The presentation was lacking in detail and we need to have more reassurance that costs will not increase. It seems difficult to see how an extension of 5 months to the contract length, will not have an impact on cost.

#### **INFRACO (Infrastructure Contract)**

This contract is under negotiation, and I have little detail on how things are proceeding. The procurement process is being managed by the Procurement sub-committee of the TPB. Andrew Holmes is the Council's representative on this committee.

As detailed design is still awaited, there is a need to integrate it with the procurement process. Wide area traffic management still remain to be addressed.

#### **Grant Awards, etc**

Appropriate grant award letters have been received for the period up to the submission of the Final Business Case and Financial Close. A cash flow profile profile was received at the end of last week from **tie** and we will be making claims to the Scottish Executive on this basis. I have also drafted a letter on Donald's behalf requesting that grant be paid to the Council **in advance** to prevent the Council suffering any cash flow disadvantage.

#### **Land Acquisitions**

The first tranche of land has been acquired. Land acquired is for Line 1a only, due to the greater uncertainty over 1b. £10.6m of grant has been carried forward from 06/07 to meet the cost of compensation payments.

## **Project Costs**

You should note that total project costs for 1A are now projected by **tie** as £517m for phase 1a (compared to the £500m in the DFBC). The £517m is net of savings assumed by **tie** for “bid equalisation” and the real figure could be closer to £545m. For commercial reasons, this information is not included in TPB papers, etc, but will be given to the procurement sub-committee. I am not entirely happy with this approach, but at least we have the information!

## **Monitoring and Reporting Arrangements**

New standardised monitoring reports are being produced to meet Transport Scotland’s requirements. I am also receiving these, though the reports need some refinement to suit the needs of the Tram Project, rather than Transport Scotland’s overall portfolio. These reports will be available on the Monday of week two of the four week reporting cycle (the Tram Project Board now meets in week three). As the timing is to meet Transport Scotland’s tight reporting requirements, a meeting will be held between TS and **tie** at the TS offices in Glasgow on the Tuesday to discuss the financial implications. Duncan Fraser (City Development) and I have also been invited to attend this meeting.

## **Transport Scotland’s Comments on the Draft Final Business Case**

Transport Scotland submitted comments on the Draft Final Business Case at the end of March. Part of the grant conditions for 2007/8 required a response to be submitted by the end of April. I have worked with Duncan Fraser (City Development) and colleagues at **tie** to produce a response, which Duncan has now submitted to Transport Scotland on Andrew Holmes’ behalf.

## **Final Business Case Development**

As part of the response to Transport Scotland’s comments on the DFBC, a working group is to be set up to manage the production of the Final Business Case. Duncan and I will represent CEC on this group.

## **Risks**

The following risks are the major ones from a Finance point of view, can be summarised as follows:

### **FUNDING RISKS**

- Transport Scotland Funding Risk – The DFBC assumed £500m of TS funding, but TS have only stated funding of £375m plus indexation taking the total to somewhere between £450m and £500m. If TS insist on a lower funding figure, there may be affordability problems. This issue will be addressed in the funding agreement.
- Developers Contributions – We are currently assuming Capital Receipts of £25m. As these projections are dependent on the pace and scale of development along the tram route, there is considerable risk attached to them.
- Capital Receipts – The Council needs to identify £10m. Available receipts may already have been allocated against the CIP.
- Insufficient funding to cover overruns – Transport Scotland have yet to give assurance that they will provide additional funding, should project costs exceed budget. This is being addressed as part of the funding agreement.

## DELIVERY RISKS

- Elections – The SNP manifesto states that the tram project should be cancelled and monies diverted to other transport projects across Scotland. Should this policy be implemented, there will be costs associated with closing down the project, some of which may fall on CEC revenue budgets.
- Final Business Case – Project depends on an affordable Final Business Case approved by both TS and CEC. Price increases, failure to agree on funding, contractor withdrawal could all lead to the Final Business Case failing.
- Programme – Key parts of the programme are slipping (notably detailed design and MUDFA) and colleagues from City Development and I are becoming increasingly concerned on the impact on costs. The procurement strategy was founded on the basis that design was done in advance to “derisk” the project and therefore reduce the risk premium built into the Infraco and Tramco and MUDFA contract prices. Similarly, utilities diversions were to be done in advance to “derisk” Infraco. This process meant that risks were being retained by **tie** to manage and potentially abortive design and diversion costs have been incurred as this was required to reduce costs and risks in the overall project. However, what has happened is that the MUDFA contract has been let and will shortly commence in earnest with detailed designs only 50% complete, due to design slippage. This means that MUDFA is likely to take longer than planned and could require numerous variations. This will undoubtedly lead to claims from the contractor. It is also worth noting that Transport Scotland have delayed MUDFA further so that works are not being carried out during the election and post-election period. The contract price for MUDFA is £45m with a risk element taking the total cost to £61m (it should be noted that the risk element is for unforeseen diversions, not for delays). City Development (unofficially) would not be surprised if the final cost of MUDFA was as high as £100m. Infraco is scheduled to be let by 30<sup>th</sup> September. If this is also let without detailed designs in place, **tie** could be leaving us open to much larger claims. There is also the risk that as MUDFA has started late with inadequate designs that it could delay Infraco, leading to further claims. Given that the Infraco contract is about £300m a 10% overrun could cause costs to rise by £30m. **tie** is reviewing its programme and will report to the May Tram Project Board.
- Contract Risks – Contracts for TRAMCO and INFRACO currently being negotiated by **tie**, with legal advice from DLA. These contracts need to pass certain risks to the contractors, without unduly increasing costs, or exposing the Council to further risks.

## ONGOING OPERATIONAL RISKS

- Passenger Growth Forecasts – this is the basis for the TEL business plan and shows passenger numbers growing over the period of tram operation. The model shows both bus and tram passengers and there are options available to cut costs/ raise fares, should these levels not be achieved.
- Concessionary Travel – It is assumed that trams will be part of the national concessionary travel scheme. This requires secondary legislation and TS are supportive, but there is still a risk that tram will be excluded from the scheme. Given the large number of concessionary passengers, this could have a significant adverse impact on revenues.

- Maintenance Contracts – Tram maintenance costs are the largest unknown cost in the TEL business plan. There is a risk that they will be increased, if there is pressure to reduce the Capital costs of the scheme to make it more affordable.

### **Project Governance Issues**

The project is being managed by the Tram Project Board (TPB), which has representatives from CEC, TS, **tie**, and TEL. The Council representative on the TPB is Andrew Holmes. The board is supported by sub-committees. There are currently three in operation – DPD (Design, Procurement and Delivery), MUDFA and Procurement. The sub-committees review papers in detail and provide recommendations to the tram project board. **tie**, as project manager, produces reports for the TPB and its sub-committees to consider and recommendations for it to approve. A weakness in its operation is that there is no independent review function (as recommended by Prince 2), to independently assess the project and challenge **tie**'s recommendation. I am also concerned by the quality of CEC representation as Andrew Holmes does not always read the papers to enable him to raise matters of concern (although he is thoroughly briefed by his staff)

It is possible that Tramco or Infraco contractors may require CEC to guarantee or be party to contracts negotiated by **tie**. Colleagues in legal are concerned about this as they have had no involvement in the process to date. However, in reality, the Council would be exposed whether it guaranteed contracts or not, as **tie** has no resources of its own.

Legal Services are drafting an operating agreement to put in place between CEC to cover the governance of the tram project. There is concern that there is no real mechanism to incentivise **tie** to perform or to penalise it for poor performance.

### **Agreement with TIE over advanced funding and banking**

New banking arrangements are in place and are operational from 1<sup>st</sup> May 2007. The arrangements mean that we pay **tie** for the tram project only when they require it so that **tie** avoid either incurring or earning interest. Interest earned on advanced payment requests is retained within CEC (although may be ring-fenced for the tram project). The next stage is to seek advanced grant payments from Transport Scotland, to avoid the Council incurring interest costs.

### **Financial Services Resources**

Currently financial support for the tram project is as follows

Officer	Current Tram Responsibilities
Rebecca Andrew	<ul style="list-style-type: none"> <li>• Provision of financial advice to colleagues in City Development</li> <li>• Reviewing financial projections and analysis provided by <b>tie</b> and attending monthly meeting with <b>tie</b>/TS</li> <li>• Provision of briefings on Tram Project Board Papers</li> <li>• Finance Rep on (Tram) Legal and Property Working Group (esp for £45m contribution)</li> </ul>

Officer	Current Tram Responsibilities
	<ul style="list-style-type: none"> <li>• Finance Rep on Contributions Working Group (on ad hoc basis)</li> <li>• Providing financial input on papers to tram Internal Planning Group</li> <li>• Development of funding agreement with Transport Scotland</li> <li>• CEC Finance rep on Final Business Case working group</li> <li>• Liaison with <b>tie</b> and Transport Scotland over grant funding issues</li> </ul>
Colleen Jennings	<ul style="list-style-type: none"> <li>• Monitoring of CEC staff resource used for tram (both internally funded and charged to tram project)</li> <li>• Billing <b>tie</b> for CEC staff</li> <li>• Grant claims and reconciliations for the Scottish Executive</li> <li>• Processing of tram invoices</li> <li>• Reconciliation of CECT bank accounts</li> </ul>
Innes Edwards/David King	<ul style="list-style-type: none"> <li>• Managing CECT accounts and transferring monies to <b>tie</b> based on cash flow requirements</li> </ul>

Currently staffing resources are sufficient. However, Final Accounts tends to be a quieter period for PFMs. In addition, it looks likely that Financial Close will slip and the Final Business Case may coincide with the 2008-11 budget process.

#### **Other Issues**

Public Realm works planned for St Andrew's Square need to be delayed so that they fit in with the tram project. This project is part of the £18m programme of public realm works match-funded by SEEL. The Council's 50% share is part-funded from the City Growth fund, which needs to be spent by March 08. SEEL's 50% contribution may also be time-restricted. If the MUDFA programme causes works to be delayed, the Council risks losing this funding.

The tram works will involve relaying sections of carriageway and footway adjacent to the tram lines. If the rest of the road/footway is not also relayed, then it will produce a patch-work quilt effect. It is also possible, that some of the work will need to be done anyway, shortly after the tram is in operation. A corporate decision is needed to address whether the Council wants to do the work, and, if so, who is going to fund it and from which budget it is to come from. The Capital Programme has been approved for 2007-10 and there is no extra money. Conceivably, it could be funded from SfC's carriageway and footway budget, but that needs to be agreed.

The Director of City Development wishes to buy the building currently occupied by Starbucks and a Chinese Restaurant at Haymarket in order to improve pedestrian access to Haymarket Station (and tram stop). The estimated cost is £3m and does not fall within the scope of the tram project. It may fall within the Haymarket Project, but this is still only in the feasibility phase. One solution is possibly City Growth 3, but that will depend on how much the Council is allocated and on other Council priorities.