

RESTRICTED – ADVICE TO MINISTERS

From: Kenneth Hogg
ETLLD: Transport Division 3
18 August 2005

Minister for Transport

EDINBURGH TRAMS: OUTLINE BUSINESS CASE

Purpose

1. To seek formal confirmation of your agreement to release up to £17.85m in 2005/06 (of the previously committed £375m total) to conclude development of the Outline Business Case (OBC) for the Edinburgh Trams project.

Priority

2. **Immediate.** You discussed with colleagues on 10 August. It would be helpful to be able to confirm the position at the **tie** Board meeting on 22 August.

Background

3. The Executive has committed to provide up to £375m for the tram network in Edinburgh. This sum is not index-linked, and we resisted calls for indexation. In September 2004 City of Edinburgh Council (CEC) submitted a Preliminary Financial Case for tram network's construction and Ministers approved a drawdown of £4m to initiate OBC development. A second drawdown of £1.54m was also agreed to enable early involvement of a tram operator to assist in design and planning.

Project Costs & Funding

4. The Executive's £375m is insufficient to fund both lines as proposed by the current Parliamentary Bills - estimated at £473m. CEC originally declined to contribute to the capital costs, but following recent discussions have suggested a contribution valued at £45m, as a combination of cash, land and additional developer contribution. CEC have linked this to a repeated request for indexation of the Executive's £375m.

Progress with the OBC

6. The Interim Outline Business Case (IOBC) is summarised at Annex A. It continues to support investment in elements of Lines One and Two to Edinburgh Airport. It sensibly proposes a phased construction programme with initial construction of key sections, and remaining sections to be completed as funding becomes available. Further work is required to agree the best phasing option and a procurement strategy that minimises risks and costs. If the proposed drawdown is agreed, by March 2006 CEC should have the information on which to base firm proposals for the priorities for investment in the tram network.

Recommendation

8 That up to £17.85m is released in 2005-06 from the £375m available for the tram scheme. It is also recommended that we state that while we welcome the recent efforts

RESTRICTED – ADVICE TO MINISTERS

by the CEC towards the overall project costs, the Executive is not prepared to meet the remaining funding gap for Lines One and Two as currently proposed.

Kenneth Hogg

ETLLD: Transport Division 3

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18 August 2005

Copy List:	For Action	For Comments	For Information		
			Portfolio Interest	Constit Interest	General Awareness
First Minister					X
Deputy First Minister					X
Minister for Finance and Public Services			X		
Deputy Minister for Finance			X		

- PS/Perm Sec
- Liz Lewis, Head of Ministerial Support Group
- PS/ETLLD
- PS/FCSD
- John Ewing
- Jonathan Pryce
- Frances Duffy
- Jamie Ross
- Bill Reeve
- David Reid – Finance
- Damian Sharp
- Fiona Spencer
- David Dow
- Andrew Caskie - Finance
- Sam Ghibaldan - Senior Special Adviser
- Adrian Colwell – Special Adviser

**EDINBURGH TRAMS: INTERIM OUTLINE BUSINESS CASE
PROCUREMENT STRATEGY**

The Edinburgh Tram project is learning from lessons from previous tram GB schemes. In particular, uncertainty over detailed design and planning has resulted in cost overruns and increased prices. These lessons, together with the constraints imposed by Edinburgh's World Heritage city centre, have convinced **tie** Ltd that detailed planning and design, and risk reduction work, should be completed before the main construction contracts are let.

Tie's proposed procurement strategy identifies a number of key contracts that will allow them to bring in-house the skills and experience of leading light rail technical design and planning contractors. While this entails higher up-front public sector investment, **tie** argue that this will help minimise cost overruns and increased risk premia on transfer to the private sector. Before this transfer, these risks will largely fall to the public sector.

Early operator involvement

A contract has been signed with Transdev: an experienced tram operator in the UK and in Europe. This gives **tie** access to the operator's knowledge and experience during the key phases of parliamentary approval, business case planning, bus/tram integration, design, and commissioning to ensure that the system will be capable of being operated effectively. Once in the operations phase, Transdev will assume a portion of the operating cost risks.

Establishment of Joint Revenue Committee

The Joint Revenue Committee (JRC) will develop a public transport modelling tool to support the development of the Tram network and integration of both tram and bus. The JRC will be responsible to **tie** along with the design contractor on a jointly and severally liable basis. The modelling tool will analyse: the impact of system design features on revenue predictions and on service and frequency changes; and the effect of changes in passenger numbers on revenue. The JRC will report on the integration with other public transport modes and this output will facilitate the development of a business plan for integration of buses and trams.

Early Designer involvement

This allows development of detailed advance design work for sensitive sections of the lines, particularly through Edinburgh's World Heritage city centre. The design contract will focus on the most sensitive sections of the network between Ocean Terminal and Haymarket via Princes Street. The early involvement of the designer should reduce risks to which bidders for the infrastructure contract are exposed and therefore the premia they would otherwise charge.

It will also facilitate the advanced works on utility diversions. This is an area where both programme and costs would present considerable risks and therefore high premia to be paid for transfer of risk to the private sector. **tie** and CEC plan to manage without such transfer. Drawing on the experience of other schemes within **tie**, they will monitor the solutions being prepared by the design contractor with the assistance of the Technical Support Services Contractor, Transdev. The purpose of this is to avoid 'gold plating' and any tendency

RESTRICTED – ADVICE TO MINISTERS

towards high risk or high cost options which do not provide the overall best value for money. Costs will be closely tracked throughout the design period, so that overruns can be identified quickly and mitigating actions taken while there is still scope to change the solution.

Advance Utilities works

Early utilities work should reduce programming and cost risk pricing by the infrastructure providers. It will also minimise disruption and through the key city centre areas. **tie** propose to retain and manage the significant risks associated with utilities. They will implement the major utilities diversions required through a single framework contract - the contractor to be approved by all the affected utilities. **tie** and CEC will use their powers under the Tram Acts and as the roads authority to negotiate with the utilities, allowing works to be carried out on all of the utilities assets at a single site under a single contract. Advance negotiations have already resulted in a number of innovative solutions for utility issues.

Separate selection of infrastructure and vehicle providers

tie will run separate competitions for infrastructure and vehicles in order to allow selection of its favoured rolling stock choice and its favoured infrastructure provider. **tie** also believes that separate procurement will increase competition for the infrastructure contract. As with the design contract it is **tie**'s intention to novate the vehicles contract to the infrastructure contract with all interface risks passing to the infrastructure contractor.

Outstanding issues

There is general agreement across all stakeholders and financial advisers that **tie**'s proposed procurement strategy will require increased attention to governance issues. The current affordability gap and the position of the Executive as majority funder exposes the Executive to continuing funding pressure. Edinburgh's World Heritage status and the expected stance of the historical environment lobby mean that there remains significant risk from exposure to proposed cost increases, particularly through cost creep and "gold-plating". There are also concerns about the proposals to separate the competitions for infrastructure and vehicles as promoted at this stage by **tie**.

The Executive is tackling these risks through discussion and consideration of tighter project governance, including the potential for the Executive to maintain a more direct influence on **tie** Ltd. rather than indirect influence through the CEC. Discussions are ongoing and decisions on these and the other issues above will be integrated into completion of the Outline Business later this year.

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**EDINBURGH TRAMS: INTERIM OUTLINE BUSINESS CASE
FUNDING & PROPOSED PHASING**

The current estimated total for the proposed network of Lines One and Two is £473m, which will not be covered fully by the Executive’s committed £375m. Currently only Line One can be built with any certainty. The current IOBC clearly indicates that CEC are unable to commit to the capital costs. However following recent discussions with the Executive, CEC have accepted that a tangible contribution from them is essential, and have now indicated a contribution valued at £45m can be made, as a combination of cash, land and additional developer contribution. CEC have made this suggestion on the condition that the Executive agree to index-link the £375m.

In the light of affordability constraints, the IOBC proposes a phased construction programme to ensure initial construction of key sections of both lines, with the remaining sections completed as funding becomes available (eg through operating surplus of the initial sections).

The current aspiration is to construct Line 1 in its entirety plus Line 2 to the Airport but if Optimism Bias contingency is included, above tie’s recommended 10% (ie at a more realistic 40%), the affordability of this is seriously threatened. It has therefore been concluded that “the Airport Network” requires a higher level of funding than is currently agreed: both indexation of the Executive’s £375m and a higher CEC contribution.

Potential for PFI / PPP Solution

The IOBC recognises that despite the current preference for a traditional funding model based on the Executive’s grant of £375m, the preliminary work indicates that there may be a case for a PPP procurement solution. CEC are not keen: indicating this would require them to take significant risks ahead of certainty about operating surplus required to service such a proposal. The ongoing OBC development includes a full evaluation to examine this further, including a full value for money assessment in line with HM Treasury guidance.

Proposed Phasing Options

Preliminary work has been done to identify discrete sections of Lines One and Two which could be built as a phased development. Initial findings – still to be confirmed - suggest the following.

A: Ocean Terminal to Haymarket		£184m.
B: Haymarket to Roseburn to Granton Square	incremental cost	£102m
C: Granton Square to Ocean Terminal	incremental cost	£41m.
D: Haymarket to Roseburn to Edinburgh Park Station	incremental cost	£122m
E: Section D + Edinburgh Park to Gogar	incremental cost	£49m
F: Gogar to Edinburgh Airport	incremental cost	£48m

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PROCUREMENT PROGRAMME, MILESTONES AND FUNDING

Activity / milestone	2005	2006	2007
Commencement of design (SDS) and related activities	Aug 05		
Royal Assent		Jan 06	
Complete Development of phasing plan		Jan 06	
PFI analysis and decision		Jan 06	
First draft of TEL Business Plan		Jan 06	
Preliminary design by SDS		Jan 06	
Submission of Outline Business Case (OBC)		End Feb 06	
Approval by CEC/SE to issue tenders for Infraco/Vehicles		End Mar 06	
Approval of funding to Final Business Case (Jun 07)		End Mar 06	
Issue of tenders for Infraco/Vehicles (if finally accepted)		April 06	
Return of tenders for Infraco and tram vehicle contracts		End Aug 06	
Review phase 1 scope in light of prices		Sept -	

RESTRICTED – ADVICE TO MINISTERS

received		Oct 06	
Review Business Case and phase 1 scope in light of output from Integrated Transport Model		Sept - Oct 06	
Tender assessment Best and Final Offers and negotiation		Sept 06 -	Jun 07
Deliver Final Business Case (FBC)			June 07
Financial close - Infraco and tram vehicle contracts			June 07