

# **EDINBURGH TRAM PROJECT**

## **GOVERNANCE, FUNDING, BUSINESS CASE AND APPROVALS – INTEGRATION WITH PROCUREMENT PROGRAMME**

### **Background**

The procurement programme has been revised following the political hiatus in May and June. Financial close is now scheduled for January 18<sup>th</sup> 2008. The purpose of this note is to suggest how the related critical workstreams can be integrated and reflects the governance approach and funding conditions communicated by Bill Reeve today.

The note attempts to pull together the activities needed to deliver the funding for the tram project, the Final Business Case (FBC) and the related areas of project governance and the approvals process. The key dates on which it is based are those within the procurement programme. I believe the approach below is the best way to execute, but there are challenges.

### **Summary**

1. TS to withdraw from regular monitoring, placing full responsibility on CEC.
2. Updated Project budget incorporating all advance expenditure to be finalised in immediate term and married up with timing of requests for new funding
3. Project scope assumed to be Phase 1a with option to construct Phase 1b. Phase 1a to be contracted in January 2008, Phase 1b to be structured into the contract as an option at CEC discretion on fixed terms
4. Preparation of a near-final FBC to be accelerated to coincide with preferred bidder selection at end-September
5. Request for additional funding also to be approved by TPB then TS at end-September, to enable advance works and early mobilisation of Infracore / Tramco to proceed
6. Other than managing new approach by TS, no material changes proposed to existing governance model. TS / CEC arrangements to be codified.
7. Funding arrangements now clarified by TS, but further work needed to finalise.
8. Gateway review 3 in early October, to be driven by tie / TEL / CEC
9. Council meeting on 25 October to approve preferred bidder and FBC including funding arrangements
10. Funding for Phase 1a to be sustained in present assumed form – Government grant + CEC “£45m”. Action underway to develop incremental funding, but is unlikely to bear fruit until 2008 and should therefore be part of the Phase 1b consideration and not introduced as another risk factor to Phase 1a.

## Objectives

The objectives for the period to financial close are :

1. The project expenditure budget through to financial close is clearly stated, fully supported by the Tram Project Team and visible to all key stakeholders
2. Cash funding is received sufficiently in advance of expenditure such that cash resources to meet commitments are adequate
3. Approval points for new funding are visible and approval processes are planned and agreed in advance with key stakeholders
4. An effective and efficient governance model is deployed through to financial close

During this period we also need to prepare for the construction period and the objectives are :

5. Contracted payment terms for Infraco and Tramco, together with any guarantee or comfort letters, are fully supported by funding commitments from key stakeholders and documented in a legally binding form in the context of the procurement process
6. An effective and efficient governance model is developed and approved for the construction period in advance of financial close

## Project Scope

I am assuming that the project scope will follow our recent discussions – Phase 1a will be contractually committed and Phase 1b will be committed in the form of a time-limited option. Subsequent extensions will be described in the FBC but will not form part of the procurement process or funding dialogue at this stage. This may change if bidders submit final proposals which change the view of affordability, but at present this is the only reasonable basis to proceed with a firm procurement and funding programme.

## Delivering the objectives

### 1, 2 Expenditure budget to financial close, current funding agreement and timing of cash receipts

The expenditure budget is being adjusted to accommodate some refinement of MUDFA and insurance premium payments. A final form will be available this week and will be submitted to the TPB on 9 August, along with an explanation of key assumptions and risks. The budget to financial close will be presented in the context of the up to date best estimate of the total project budget, with placemaker sums for major variables including the Infraco / Tramco bid numbers. This is also the budget which is reported against 4-weekly to TS so that they will also have full visibility.

The existing funding agreement for £60m will be married up with this budget. It was understood when the £60m facility was approved that this would not be adequate to finance the full period through to construction commencement and the expectation was that the funding would run out in October, coinciding with the previous assumed date for FBC approval. That date has moved forward to January. In addition, the current

programme requires earlier execution of certain works, known as Advance Works Phase 2 which include early mobilisation of Infracore and Tramco. Accordingly, the revised budget will incorporate all works which are required to maintain programme. It is recognised that the agreement to new funding creates an approval issue and this is addressed below.

The timing of cash receipts will be addressed as part of this process to achieve objective 2. At present CEC provide the buffer but we must align their cash flow with ours as closely as possible.

### **3, 4 Approvals and governance in period to financial close**

The present governance model will prevail through to financial close with the following amendments :

- The addition of the Legal Affairs Committee (LAC) and the possible resurrection of the Business Case, Integration and Commercial Committee (BPIC). An alternative approach is to combine the BPIC material within the Procurement sub-committee process, but the same issues need addressed. The purpose of these has been discussed or is obvious. The DPD and MUDFA committees continue as now. All Committees are designed to expedite review and resolution of key issues, none have formal decision-making power which is reserved to TPB.
- TS will withdraw from the regular project governance and management processes, other than receiving the 4-weekly report as now. The additional meetings they wish to have with CEC need to be addressed to avoid duplicate processes. The communication and approval at key stages also needs to be codified, but the light touch principle is agreed.

The principal workstreams which need to be coordinated are :

- Procurement
- Design
- FBC preparation
- Funding

The suggested outline programme is set out below. The procurement programme requires that the TPB meeting approves the Conditional Contract Award Recommendation on 27 September with financial close in January 2008. The programme outlined below accommodates the procurement programme but the key new dimension is the suggestion that we seek to have the FBC effectively completed, based around the preferred bid, in time for the TPB meeting on 27 September. This document will be referred to as FBC Version 1, with final form FBC Version 2 as the basis for financial close. It is anticipated that there will be minimal difference between these two documents.

The reasoning is that :

- The preferred bid numbers should be robust, otherwise we would not be in a position to recommend a preferred bidder – if this is the case we should be able to prepare the FBC confidently around these numbers
- Approval on 27 September of the preferred bidder and of FBC Version 1 by the TPB would facilitate approval of the same proposition by the full Council on 25 October. This would enable the project team to inform the preferred bidder in formal terms, which will streamline the subsequent process and limit the scope for uncertainty and risk of leaks. The team are confident they can sustain adequate competitive tension over the period to finalise the contractual terms.
- This acceleration avoids a disjointed two-stage process for all stakeholders and in particular the need to have key documents approved over the Christmas period
- Pressure of time will eliminate unnecessary work – the work to update the FBC is underway and an assessment is being made of the means to minimise changes from last year's DFBC, which was the product of extensive (and costly) work. The necessary changes are largely contained in the sections on procurement process, risk transfer and affordability. These revolve around the final contractual arrangements with the bidders. All other aspects are largely as stated a year ago. Issues like EARL and changes to TEL operational assumptions can be captured in new sensitivity sections. TS's previous comments on the DFBC were largely benign and easily incorporated.
- Approval of the FBC Version 1 and the preferred bidder in September will support an application for the new funding required to take the project through to financial close, including Advance Works Phase 2 (see above). This should help TS considerably in their assessment of the grant of that additional funding, even if CEC make a contribution. In turn, this will facilitate timely execution of the Advance Works Phase 2. This needs turned around quickly to meet the programme and early dialogue on the "business case" for the advance works and early mobilisation will be necessary.
- Publication to the bidders of these additional dimensions to the programme should help rebuild confidence and help our team turn the screw on their pricing deliberations.

The critical dates are set out in summary below and it is implicit in the references to FBC V1 that full agreement has been reached on all key terms of the Infraco / Tramco contracts and on the funding agreement between CEC and TS :

- End-July** Issue of a more detailed version of the outline programme linked to the existing procurement programme and agreement of all key tie / TEL / CEC and TS people to deliver
- End August** Draft of FBC V1 available for tie / TEL / CEC review, including best estimate of preferred bid based on end-August returns from bidders (draft revised sections will be circulated during August, BPIC / Procurement Group meetings will be convened to address issues and to help manage progress and the TPB will be updated on 9 August and 6 September).

- Mid-Sept Finalisation and informal approval by tie / TEL / CEC of 1) FBC V1 2) preferred bidder recommendation 3) application for additional funding
- 27 Sept TPB approval (and recommendation to TEL Board / CEC) of same [preferably alongside draft report to Council].
- End-Sept TS approve additional funding
- Early Oct Gateway 3 review, confirmation to TS on critical issues
- Oct 20<sup>th</sup> Report and supporting documents circulated in advance of full Council meeting on .....
- Oct 27<sup>th</sup> Full council meeting to approve FBC V1 and preferred bidder recommendation
- End-Oct TS notified of Council approval
- Nov / Dec Completion of all contractual and funding documentation, update to produce FBC V2, official level approval by all
- Dec \* TPB approval, recommendation to TEL Board / CEC (\*date may need revised)
- 20<sup>th</sup> Dec Report to full Council, which should reflect only marginal changes to form agreed in October
- To 18<sup>th</sup> Jan Finalisation of documentation, final negotiation etc

The key dependencies are :

- Design progress
- Procurement programme and continued bidder support in the competition till the end of August
- That the Project Team and CEC officials can work effectively together to ensure CEC approvals to all aspects are executed timeously
- That the Gateway Review can be organised in this timeframe
- TS process
- Network Rail immunisation
- That no show-stoppers emerge anywhere

#### **5, 6 Construction period funding and governance**

Planning for funding arrangements for the construction period needs to be done in tandem with the payment mechanism negotiated within the procurement process. The principles and funding flows based on estimates will be progressed between CEC and TS with the objective of having an agreed structure in place within the procurement timetable. This will include letters of comfort from stakeholders as required. Progress on this aspect will be reported as part of the reporting on overall procurement progress. The arrangements will be set out in the FBC V1.

The FBC V1 will also include the proposed governance model for the construction period.

## Sources of funding

The revised funding arrangements set out by the Minister as a condition of continued Government support create an opportunity for CEC to develop a different approach to funding their commitments. This includes conclusion of developer contributions, prudential borrowing, leasing and utilisation of TEL cash flows. However, it is unlikely that these can be sufficiently developed to be a confident element of FBC V1 (or V2). It is therefore suggested that the funding structure for Phase 1a (Airport / Newhaven) is kept as simple as possible, with the arrangements for Phase 1b (Roseburn / Granton) being subjected to further analysis in 2008 in line with the planned duration of the period in which CEC has an option to construct.

The funding components for the construction phases will therefore comprise :

### *Phase 1a principal funding*

- Executive grant - £500m award
- CEC cash and land contributions
- S75 land contributions (principally Forth Ports)
- Other S75 contributions which are substantially agreed and incorporated into CEC funding
- CEC asset sales and / or borrowing mechanism as required

These will need to be firmly agreed in line with the programme described above. The extent to which the other sources described below are affected by these arrangements must also be assessed and “future-proofed”. An example would be the possibility of leasing arrangements which attach to equipment (eg tram vehicles) needed for Phase 1a as well as Phase 1b. This should be manageable.

### *Additional sources of funding (Phase1b and further extensions)*

- CEC / TEL borrowing or leasing
- Developer contributions and related asset sales, especially Granton
- TEL resources, other than borrowing
- Third party grants (eg SESTRAN)
- Tax shelter mechanisms
- Other to be developed

The development and corporate and tax structuring in support of these sources needs further development. The work to do so has commenced but it is likely that finalisation will emerge in 2008.

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