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EDINBURGH TRAMS: DRAFT FINAL BUSINESS CASE AND START OF UTILITY DIVERSIONS

Purpose

- ◆ To seek your agreement that we release £60m funding to undertake utilities diversions and allow time to conclude the analysis of bids for tram vehicles and infrastructure

Previous Consideration by Cabinet

1. Cabinet last considered the Edinburgh Tram Project as part of its discussion of the Transport Infrastructure investment plan in December 2005. At that time Cabinet agreed in principle to:

- ◆ support Phase 1a of the tram scheme from Leith Waterfront to Edinburgh Airport;
- ◆ index link Scottish Ministers' contribution of £375m at 2003 prices using the Transport Scotland index for major rail schemes. In return City of Edinburgh Council would contribute £45m and take revenue risk on the operation of tram and bus services;
- ◆ review the scheme again following production of the draft Final Business Case

2. Following that Cabinet discussion I met the Minister for Finance and agreed that a conventional procurement strategy was appropriate for the tram scheme as PPP did not represent good value for money. My officials have pressed time Ltd to demonstrate that the risk transfer disciplines of PPP have been applied as far as possible within a conventional procurement structure. Significant design and construction risk is transferred to the infrastructure contractor for the tram scheme and long-term operating cost risk lies with Transport Edinburgh Ltd (TEL) as the operator of tram and bus services. TEL is owned by City of Edinburgh Council but operates as an independent company.

Progress since December 2005

3. Royal Assent for both Tram Private Acts was achieved in Spring 2006 giving time Ltd powers to construct the tram. time's readiness to implement the tram scheme has undergone significant review including OGC Gateway 2. Following these reviews action plans have been implemented to address project and commercial issues.

4. Procurement work for the tram has continued and the utilities diversion contract (known as MUDFA) has been let and design and mobilisation for MUDFA have taken place. Bids have been received for tram vehicles within the range expected and initial bids for infrastructure have been received and are being evaluated.

Scheme information

5. The Scottish Executive has committed to supporting Phase 1a of the tram scheme which runs from Leith Waterfront to Edinburgh Airport via Leith Walk, Princes St, Haymarket and Edinburgh Park. City of Edinburgh Council has continued with the development of Phase 1b of the tram which would run from Haymarket to Granton. No

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Executive commitment has been made to Phase 1b. Phase 1a provides the spine of the network and lays the foundations for extensions to the network which can be pursued without incurring some of the fixed costs of the first part of the network. This makes extensions more attractive to developers and experience in other UK and European cities has seen developers being more willing to contribute to extensions than to the core network.

6. The tram will be operated by Transdev (a world-leading tram operator) as part of an integrated network with Lothian Bus services. The tram will replace some bus services in the North and West of Edinburgh but bus will remain the principal public transport option within the city. The introduction of the tram will lead to a significant improvement in the perceived quality of public transport available and this is what drives the predictions that tram will attract additional passengers compared to bus. However, for some people the introduction of the tram will mean that they will have to change from bus to tram for a journey they can currently complete on a single bus.

7. Further detail of the tram scheme, proposed bus service alterations and a map of the network is included at Annex C.

The case for Trams

8. The case for trams is made by tie in its draft Final Business Case (FBC) for the scheme which has been drawn up in line with standard appraisal practice. That case is marginal for Phase 1a but needs to be seen in the context of the importance of tackling congestion in Edinburgh for the Scottish economy.

9. Edinburgh has a crucial role in the Scottish economy and the West of Edinburgh in particular has contributed significantly to growth in the Scottish economy through financial services and knowledge-based industries. That economic growth has brought increased pressure on transport networks including significant growth in congestion which is forecast to continue and in turn congestion will threaten economic performance.

10. City of Edinburgh Council has pursued a variety of policies to encourage more sustainable travel and has had success with some of these – notably in terms of encouraging high bus ridership. However, the failure of congestion charging has left Edinburgh with only one remaining option for significant intervention to boost public transport within the city and that is the tram. The tram alone will not be sufficient to tackle the capital's congestion problems but without the tram we would be relying on future economic measures to restrain traffic growth.

Draft Final Business Case

11. tie has conducted 3 tests of the viability of the tram scheme:

- ◆ **economic viability** – a standard assessment of the quantifiable benefits and costs of the scheme plus environment, safety, integration and accessibility impacts;
- ◆ **financial viability** – whether the scheme integrates with bus services and whether the combined bus and tram services can operate without subsidy;
- ◆ **affordability** – whether the initial capital costs are likely to be affordable within the available funding.

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12. tie argues that all 3 tests have been met for Phase 1a and that the economic and financial viability tests have been met for Phase 1a + 1b¹. In particular Phase 1a is projected to be affordable within the available funding, cover its operating costs from revenue from year 2 of operation and have a benefit cost ratio (BCR) of 1.10.

13. The breakdown of the capital cost of the tram scheme is set out in the table below:

	Phase 1a) £m	Phase 1b) £m	Total £m
Utilities	50.2	7.4	57.6
Tram Vehicles	55.9	8.5	64.4
Infrastructure	241.6	54.6	296.3
Other Third Party Works	2.0	0.6	2.6
Land and Property	22.0	4.1	26.1
Design	22.1	1.9	24.0
Project Management, commercial etc	74.9	8.0	82.9
Risk	48.6	8.0	56.6
Total	517.5	92.9	610.4

tie's estimate for Phase 1a includes £28m of savings to be achieved. Essentially the risk figure is shown as risk net of savings.

14. tie's evidence is that line 1a would cost £477.5m – 517.5m and is therefore affordable within available funding with a benefit cost ratio (BCR) of 1.10 and a maximum of 83% falling to 80% (2031) of patronage is drawn from existing bus use. tie and City of Edinburgh Council will therefore argue that they have met the conditions set by Ministers and Transport Scotland's Investment Decision Meeting (IDM) at their last consideration of the tram scheme. My officials have reviewed the draft FBC and the key points of their review are:

Economic viability test

- The assumptions made by tie in the business case for the tram are key to the positive BCR of 1.10 and the case for the tram is now marginal and very sensitive to assumptions.
- Transport Scotland's view of costs is more cautious than tie's and their cost estimate for Phase 1a lies in the range £510-545m. No formal analysis has been undertaken, due to time constraints, of the impact of Transport Scotland's view of the costs on the BCR but there would be a negative impact.
- The tram supports economic development at Leith Waterfront, West Edinburgh and, subject to line 1b, Granton Waterfront. The appraisal attributes 590 Full Time Equivalent jobs to Phase 1a and a further 340 to Phase 1b.

¹ Phase 1b runs as an extension of Phase 1a from Haymarket to Granton.

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- The assessment of the Edinburgh Tram Project assumes it is covered by the national concessionary travel scheme. As concessionary travellers make up roughly a quarter of all tram passengers, and because of the resultant reduction in bus services, failure to include the tram within the national scheme would have a significant negative impact on public transport accessibility within Edinburgh, for the group covered by the national scheme.

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Financial viability test

- The forecast operating surplus relies on achieving significant passenger growth for the public transport network and fares increases at RPI+1%. This is based on expected transport demand in Edinburgh and on the performance of Lothian Buses which has achieved greater annual passenger and revenue growth since 1998 than that which is predicted in the draft FBC.
- The draft FBC is predicated on the Edinburgh Tram Project being covered by the national concessionary travel scheme. As concessionary travellers make up roughly a quarter of all passengers, failure to include the trams in the national scheme would threaten Transport Edinburgh Limited financial viability and would lead to both a subsidy requirement for the tram and reduced efficiencies in bus operation.
- The inclusion of tram in the concessionary fares scheme would fall to be negotiated as part of the renewal of the scheme and a large amount of the funding required is already being paid to Lothian Bus for existing concessionary travel. There would be some additional pressure on the national concessionary fares scheme from the generated travel and from the renewed arguments that Glasgow Underground should be included. To a large extent the concessionary fares pressure from the tram itself could be offset by reduction in Bus Service Operators Grant payable to Lothian Buses as fewer bus miles would be run.

Affordability test

- Using the same inflation assumptions and profile as the cost estimate the Executive's £375m in 2003 prices would be worth £490m giving total funds available of £535m.
- Transport Scotland's view of costs is more cautious than tie's and their cost estimate for Phase 1a lies in the range £510-545m. A significant element of that range lies within available project funding but not all of it. It is therefore probable but not certain that Phase 1a will be affordable without the need for additional funding from City of Edinburgh Council.
- Phase 1a plus 1b would cost £610m and will not be affordable within available funding unless significant additional savings are achieved. However, phase 1a plus 1b performs significantly better in BCR terms (1.63).
- There are significant levels of risk remaining with the project especially in relation to the programme for delivery and affordability.
- Overall levels of risk and contingency within the scheme amount to 8% whereas we would normally wish to see 20% at this stage of a scheme's development to be confident in affordability. However, there are significant opportunities for cost savings that could increase the level of contingency available. Real evidence of that would be required through robust value engineering and successful negotiation with the Infraco bidders over the period to September 2007.

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- Very robust project management will be required to manage risk, maintain programme and ensure project remains within the funding available.

15. Annex A sets out further analysis of the business case and Annex B analysis and mitigation for the key project risks.

Experience in other Cities

16. Tram schemes have been implemented in several English cities and in Dublin. They have had clear benefits in tackling congestion and encouraging economic development. On my recent trip to Dublin I heard firsthand how initial opposition had been turned round by the success of the tram and heard how developers are now pressing for extensions to the tram and are willing to fund a significant proportion of an expanded network.

17. In some cases benefits were slower to arise than originally predicted and competition from bus services threatened early schemes such as Sheffield. Edinburgh has learned from experience in other cities and has benchmarked its costs and benefits. In particular, the creation of Transport Edinburgh Ltd as a single economic entity covering Lothian Buses and the tram provides a strong basis for achieving an enhanced and integrated public transport network in Edinburgh.

Differences from heavy rail projects

18. Colleagues will wish to note that there are some significant differences to the financial structure of the tram scheme compared to heavy rail projects. Our contribution to the tram scheme would be a capital grant with no requirement for ongoing subsidy. Tram vehicles would be bought rather than leased and so form part of the cost of phase 1a.

19. Purchase of tram vehicles means that the tram scheme will generate sufficient revenue above operating costs to cover maintenance and some of the life cycle renewal of the infrastructure. However, unlike the heavy rail industry where our funding of Network Rail secures the operation, maintenance and renewal of infrastructure in perpetuity, there would not be sufficient operating surplus to fund the major infrastructure and rolling stock renewal that would be required after 30-50 years of operation.

Project control

20. The tram has been subject to Transport Scotland's quarterly review process and monthly monitoring by my officials. Bill Reeve, Director of Rail Delivery, Transport Scotland sits on the Tram Project Board within a clear framework of delegated responsibility for developing the scheme. Since Cabinet last considered the tram scheme tie Ltd has strengthened its internal team and is improving its internal project control disciplines. This progress must be maintained. The tram project has also been through the Scottish Executive Gateway 2 review and an action plan is being followed to implement the review's recommendations.

21. I have asked Transport Scotland to review the risks in relation to the tram project and to ensure that funding released is accompanied by further improvements in project control as the scheme moves towards full implementation.

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22. A final decision to commit to infrastructure and tram vehicle procurement is not required before late Summer 2007. However, the momentum behind the tram will certainly increase significantly once utilities diversions are underway. Delay in utility diversions would, on the other hand, add very significantly to the risks facing the scheme and would certainly delay the completion of the scheme.

23. I will now require tie and City of Edinburgh Council to implement improved project controls, provide further evidence of scheme affordability and continue to comply with Transport Scotland's project review programme including the Scottish Executive Gateway 3.

Why proceed with investing £60m at this stage?

24. Investing £60m at this stage will allow tie ltd to continue with their strategy of undertaking utilities diversions separately from the procurement of tram vehicles and infrastructure. Diverting utilities before main construction starts significantly reduces the risk to the infrastructure contractor and we would expect to see that reflected in the Infraco bids.

25. Given contractors' experience with other UK tram schemes, tie ltd and Transport Scotland have had to work very hard to maintain a viable procurement competition. Despite this there are only 2 infrastructure bids which poses a risk to the project. To minimise this risk tie ltd must maintain the confidence of bidders that the scheme will go ahead – to delay a decision at this stage would cause significant concerns to the bidders and could lead to either or both withdrawing from the competition.

Why not proceed with Phase 1b at this stage?

26. tie ltd and City of Edinburgh Council are pressing for a positive decision on Phase 1b also at this stage and the Council has indicated a willingness to increase its contribution by £10m towards the costs of phase 1b.

27. I do not agree to their request for the following reasons:

- although the inclusion of phase 1b would significantly improve the BCR of the scheme the total capital cost is not affordable within the available funding even with an additional £10m from CEC – this would therefore cause us to exceed the budget for major public transport projects
- to give a commitment now would significantly reduce leverage on developers and the infrastructure bidders to provide additional contributions and demonstrate efficiency respectively
- no decision on Phase 1b is required at this stage and I would wish to see evidence of additional savings being generated by tie's management of the contractors before giving any commitment to Phase 1b

Presentation/Handling

28. This is a very significant investment in Scotland's capital and I would wish to make an announcement of the decision urgently followed by a site visit to coincide with the start of utilities diversions work towards the end of March. A full media plan is being prepared.

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Conclusion

- ◆ The tram represents a significant opportunity to demonstrate our vision of a competitive Scotland committed to tackling difficult and entrenched problems such as congestion
- ◆ The scheme needs to be managed very robustly and I will be requiring further improvements in project governance and control from tie ltd and City of Edinburgh Council
- ◆ The scheme can be delivered within the Budget envelope that Cabinet previously agreed
- ◆ I therefore seek your agreement that we release £60m funding to undertake utilities diversions and allow tie to conclude the analysis of bids for tram vehicles and infrastructure

TS
FEBRUARY 2007