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To: Hugh Dunn, David Robertson, Karen Kelly, Donald McGougan, Ian Stirton

Tram briefing – 14th May 2008

1 Introduction

- 1.1 This paper is intended to give you an update on the main issues/workstreams associated with the tram project.

2 Funding Agreement with Transport Scotland (TS)

- 2.1 TS have now contributed £153m to the project to facilitate spending to the end of period 2 (period ending 24th May 2008). The latest cash application to TS was for £5.8m and should be in the Council's bank account in the next 2 weeks.

3 Council Reporting/Contract Signing Delay

- 3.1 Slippage on Financial Close had been detailed in previous briefings. CAF (Tramco) signed on 13 May 2008. BBS (Infracore) are expected to sign on the afternoon of 14 May 2008.
- 3.2 A report on Financial Close and Notification of Contract Award went to Council on 1 May 2008. This report asked Council to note the imminent award of the Infracore and Tramco contracts and also asked the Council to refresh the authority given to the Council's Chief Executive to allow **tie** to enter into the contracts, previously given in the Council report of 20 December 2007.
- 3.3 Given the changes to programme and price from the 20 December 2007 report, the Chief Executive felt it was in the best interests of the Council to request that Council refresh the delegated powers given in the previous report as a result of a 5 month delay to programme and a £10m increase in price.
- 3.4 At the point of the 1 May 2008 Council Report it was expected that Financial Close would be circa 2 May 2008.
- 3.5 On 30 April 2008 a request from Bilfinger Berger (BB) for a further £12m emerged.
- 3.6 BB's support for the price increase focussed around an admitted failure on their part to assess or control their supply chain prices with particular reference to increases in steel and fuel costs, £ / € movement and a claim for underwriting of central demobilisation cost which they had allocated to their bid for Phase 1b in the light of a more cautious view on the execution of 1b.

- 3.7 BB claimed their costs were actually £17m, but that they had reworked internally to arrive at £12m.
- 3.8 An additional payment of £1m has also been paid to SDS at Financial Close. This payment has been made out of contingency, therefore, no impact on the global price but has reduced the amount in the QRA by £1m.
- 3.9 On 5 May 2008 a meeting of **tie** senior management culminated in a proposal from **tie** that **tie** would :
- Absorb £3m of additional cost in return for tangible contractual and risk improvements ;
 - Agree to meet BB Siemens (BBS) allocated demobilisation costs of £3.2m in event that Phase 1b does not proceed
- 3.10 A formal letter to BBS in the form of an ultimatum was needed to bring matters to a close. In addition to the continuing delay and attendant costs, and the unpalatable alternatives to concluding with BBS, there were concerns that Siemens, CAF and PB (SDS Contractor) may also seek price increases if BB were seen to be making inappropriate progress.
- 3.11 A combined meeting of the TPB and **tie** Board was held (as scheduled) in the morning of 7 May 2008. The meeting reviewed the position thoroughly and concluded that the approach which best protected the public sector's position would be to seek a conclusion with BBS within their demand for £12m.
- 3.12 Further negotiations were conducted from 7-9 May 2008 and an acceptable conclusion reached. The final terms negotiated reflect agreement by **tie** to increased consideration and contingent cost underwriting in return for early progress to contract signing, improvement in terms and capping of cost exposures.

The specific terms are as follows :

Financial amendments:

- Incentivisation bonus – **tie** will pay a series of incentive bonus payments over the life of the contract on achievement of specified milestones. The aggregate cost will be £4.8m.
- Phase 1b cost allocation – **tie** will underwrite demobilisation costs allocated to Phase 1b in the BBS bid in the event that Phase 1b doesn't proceed. The quantum is £3.2m and this will not be paid if Phase 1b does proceed.
- Loss reserve – **tie** has agreed to waive its interest in any residual value from the £3m BBS pot for settling uninsured third party economic and consequential loss claims. This is a theoretical concession of one-third

of £3m but has never been accounted for in project cost estimates and is therefore neutral to **tie**.

- 3.13 The financial amendments were offset by the following improvement in terms.
- 3.14 Immediate contract close on preferred terms - all of **tie's** preferred positions in the Infraco contract which were under query by BBS and their lawyers would be accepted. The documents concluded include the Review and Design Management Plan arrangements which assist management of the design and consents risk and which carries a £3.3m allowance in the QRA. The attempt by BB to revise the design process in a manner which would have created delay was also successfully rebuffed. Achievement of close also reduces extended legal and management costs.
- 3.15 Elimination of risk of claims arising from works underway - closing out the Mobilisation and Advance Works Contract and waiving any entitlement to claims or relief gives **tie** a clean financial start to the contract management of the Infraco contract. This creates an immediate forward-looking focus and the avoidance of difficulties in dealing with immediate claims, spurious or otherwise. **tie** has not been notified of any claims to date, but there have been some difficulties in the early works which could have given rise to claims in the hands of a determined contractor. An outline might be in the range of £1.7m. This would be resisted, but the new agreement eliminates the risk.
- 3.16 Capping of road reinstatement cost exposure – An exposure exists in relation to the roads reinstatement pricing assumption. The QRA allows for £2m above the bid price to cover the exposure. BBS have agreed to cap their claim under this heading at £1.5m resulting in a saving of £0.5m.
- 3.17 Capping of roads related prolongation – the consortium will take the risk on prolongation beyond 8 weeks enabling the contingency to be limited to that level and reducing the need for provision by £1.3m. Other improvements affecting contamination and design & consents risk are evaluated at £0.5m.
- 3.18 Entry of CAF into Consortium – while welcoming the entry of CAF into the consortium because of improved consortium cohesion, **tie** had concerns about the potential implications of aspects of the mechanism. BBS have now confirmed they will follow the terms requested by **tie**, removing excessive negotiation timescales and costs. Specifically, the terms of the BB and Siemens Parent Company Guarantees will be amended to reflect CAF's entry into the consortium, express amendments will be made to the two bonds provided by the BBS sureties and an additional indemnity up to £8m will be provided by BBS covering contingent adverse consequences of CAF joining the consortium (note this indemnity is over and above the full set of

existing security arrangements and will expire when all parties determine that there is no residual risk, leaving the full security package intact). There is no change to the CEC guarantee in any respect but CEC will be requested confirm knowledge of CAF's entry into the consortium in a letter.

- 3.19 In summary, the late price pressure from BB arising from their claimed supply chain pressure has been contained at £4.8m with a further potential cost of £3.2m if Phase 1b does not proceed.
- 3.20 This now means the estimated costs stands at £516m if Phase 1b does not go ahead and £513m if Phase 1b is executed.
- 3.21 Clearly the increased price of Phase 1a has impacted on the headroom within the overall budget and as a result the funding gap for Phase 1b now stands at £55.3m based on a price of £87.3m for Phase 1b.
- 3.22 An evaluation of **tie's** alternatives to negotiating the £12m demand from BB concluded that there was no commercial alternative which would better protect the public sector's interests given the current situation. **tie** had advised that flat refusal to pay BB would result in BB walking away from the deal.
- 3.23 The alternatives considered were :
- Siemens to restructure consortium by incorporating a new civils contractor
 - Tramlines re-introduced
 - Full-scale re-procurement
 - Project termination
- 3.24 The first 3 alternatives would result in varying degrees of delay from 3 months to a year. Given the costs of any re-procurement, the rate of construction inflation and fuel prices as well as potential for differing contractual stand points of alternative bidders would in all likelihood be greater than the current price. Any subsequent delay would also impact on revenue generating operations.
- 3.25 The Quantified Risk Allowance (QRA) had reduced initially from £49m to £32m as a result of close out of procurement risks. The QRA has been further reduced to circa £30m based on a small amount of risk reduction as a result of final negotiations removal of £1m contingency for the additional SDS payment noted in paragraph 3.8

4.0 Phase 1b

- 4.1 The final date for a decision on the execution of Phase 1b had been March 2009. Given the slippage in Financial Close this date has now been extended to July 2009. A project team has been set up to look at the business case for Phase1b. Patronage figures will be re-assessed, economic development and potential sources of finance will form part of the remit of the team.

5 Update on MUDFA (Contract for Utility Diversions)

- 5.1 Progress has reduced from that achieved in Period 13 with 70% of the planned diversions completed in the period. A total of 77% of the planned diversions have been achieved in total to date. The overall effect on the critical path remains at two weeks and implementation of the revised recovery programme actions is underway. Rescheduling of key areas has been carried out to address resource peak demand and to prioritise critical interface areas with Infraco.
- 5.2 Excavation works carried out under MUDFA unearthed skeletal remains of three bodies thought to be about 300 – 400 years old in Constitution Street. It is the opinion of the CEC archaeologist that more finds are likely. A report compiled by the archaeologist is expected mid May to allow a decision to be made on the way forward. MUDFA progress will not be impacted by this but action will be necessary to prevent Infraco works being impacted.

6 SDS (Systems Design Services Contract)

- 6.1 The SDS v31 design programme has been issued and incorporated into the final contract. To date, 16 Prior Approvals have been issued to CEC and 11 have been approved against a programme of 21 issued and 11 approved. Twelve Technical Approvals have been issued to CEC and none have been approved against a programmed 16 issued and 4 approved. A new taskforce composed of senior representatives from **tie**, CEC and SDS has been set up to ensure the approvals are granted promptly.
- 6.2 The quality of designs for Technical Approvals in particular is still causing concern.

7 Council Contribution

7.1 Council's contribution is to be made up from a variety of sources. The latest position is detailed below:

7.2 **CEC Cash - £2.5m (No Change)**

7.3 **CEC Land - £6.2m (No Change)** - £4.3m is for Phase 1a. The £4.3m £2m of the £6.2m is for Phase 1b. If Phase 1b does not go ahead alternative funding sources will be required.

7.4 **Developers Contributions Land - £2.2m (No Change)**

Of the £2.2m land contribution from developers £1m relates to Phase 1b. Again if Phase 1b does not go ahead further funding sources will be required.

7.5 **Developers Cash Contributions - £25.4m**

Contributions from developers have always been identified as a key component of the Council's financial contribution to the project. **£3.04m** has been contributed to date.

7.6 **Capital Receipts - £9.7m** – The Council's figure of £9.7m is net of risk. The assumptions behind the amounts available via Capital Receipts has been independently assessed the findings of which were that this figure is achievable.

8 Cashflow

8.1 The cashflow profile for the project has changed substantially in 2007/08 and 2008/09 due to the slippage in signing of the Infraco contract. The first milestone payments to CAF and SDS have been made of £11m and £6m respectively. A further initial payment of £30m will be made to BBS on Financial Close. These payments are largely for mobilisation payments and advance steel purchases. Table 1 shows estimated annual cashflows with the corresponding gross contribution required from the Council.

Table 1 – Based on tie Period 13 Cashflow

Year	Cashflow £m	Transport Scotland Cap £m	CEC Estimated Contribution (8.3%) £m
06/07	39.6		3.3
07/08	48.9		4.04
08/09	199.9	120.0	16.5
09/10	126.3	149.0	10.43
10/11	84.1	Balance + Slippage	6.94
11/12	10.0		0.82
12/13	0.14		0.01
	508.94		42.04

8.2 Transport Scotland funding is capped at £120m for 2008/09 with **tie's** current cashflow forecast £199.9m. A concerted effort will have to be made to monitor **tie's** cashflow forecasts in the next year with this cap in mind. This potentially could result in an increased borrowing requirement by the Council. TS have contributed £153m cash to date. The following two financial years provide £120m and £149m respectively with the balance of funding up to the maximum of £500m provided in 2010/11.

9 Capital Cost

9.1 The Final Business Case (FBC) aggregate estimate for Phase 1a was £498m as reported to Council on 25 October 2007.

9.2 Recent negotiations with the preferred bidder have resulted in an increase in the overall cost of the project. The make up of the estimated cost of Phase 1a in the FBC was £498m which included base costs of £449m and a Quantified Risk Allowance (QRA) of £49m. The base cost has now increased to £481.8m with a revised QRA of £30.2m giving a final estimated cost of £512m, which excludes the rebate of £3.2m if Phase 1b does not go ahead.

The QRA has reduced from £49m at FBC to £32m. The QRA has been reduced further at Financial Close to circa £30m

9.3 tie Ltd have advised that the £30m QRA is adequate.

10 Financial Services Workstreams

10.1 Financial Services staff are involved in a number of key workstreams and sit on various groups relating to the delivery of the project. This is detailed in Table 2 below.

Table 2

Officer	Current Tram Responsibilities
Alan Coyle/Rebecca Andrew	Representative of CEC Finance on Phase 1b Project Team Provision of financial advice to colleagues in City Development Representation at Legal Affairs Committee Review and scrutiny of financial projections and analysis provided by tie and attending monthly meeting with tie /TS Provision of briefings on Tram Project Board Papers Finance Representative on Property and Legal Internal Group and related workstreams Forecasting of the CEC's contribution to the

Officer	Current Tram Responsibilities
	<p>project in cashflow terms including liaison with Treasury colleagues</p> <p>Tracking of project cashflows against available funding and effect on CEC borrowing requirements</p> <p>Providing financial input on papers to tram Internal Planning Group</p> <p>Liaison with tie and Transport Scotland over grant funding issues and monthly reporting</p> <p>Input to and creation of Council Reports on Tram related matters.</p> <p>Investigating financing options for Phase 1b including tax advantages relating to leasing assets to TEL</p> <p>Briefings to Financial Services Management Team</p>
Colleen Jennings	<p>Monitoring of CEC staff resource used for tram (both internally funded and charged to tram project)</p> <p>Billing tie for CEC staff</p> <p>Grant claims and reconciliations for the Scottish Executive</p> <p>Processing of tram invoices</p> <p>Reconciliation of CECT bank accounts</p>
Innes Edwards/David King	<p>Managing CECT accounts and transferring monies to tie based on cash flow requirements</p>
Hugh Dunn	<p>Support on issues surrounding £45m, especially the generation of Capital Receipts</p>
David Robertson	<p>Support on issues surrounding the Funding Agreement with Transport Scotland</p>

11 Key Dates

Table 3 highlights key dates on the project in the current period to financial close and into the future.

Table 3- *Robin Goodwin*

18/03/08	Notice of Intention to Award to Preferred Bidder
13&14/05/08	Financial Close – signing of all documents.
31/07/09	Latest date for a decision to instruct <i>tie</i> /BBS to commence 1b
27/01/11	Construction Complete Phase 1a
July 2011	Operations commence - Phase 1a.

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