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Ministerial Briefing Note

Edinburgh Tram Project

6th July 2011

Council decision

The Council decision of 30th June 2011 gave permission to continue the tram project to St Andrew Square with a cost estimate of £773m, subject to funding being available and greater detail being brought to the 25th August 2011 Council meeting in order to allow a fully informed decision to be made.

The relevant details of the Council decision were as follows;

8.1 (a) Agree that of the options available, and subject to funding, Option (iii) (Airport to St. Andrew Square/York Place) should be pursued to provide a revenue generating service and realisation of the investment to date;

8.1 (b)(i) subject to 8.1 (b) (ii) below, authorises the Chief Executive to enter into the Settlement Agreement (substantially on the terms set out in the Settlement Agreement summary) in respect of option (iii)

8.1 (b)(ii) agrees that the Settlement Agreement will not become unconditional until the Council is satisfied that there is sufficient funding available and that the project has been sufficiently derisked

8.1(b)(iii) instructs the Chief Executive to bring a report back to the Council (prior to any deadline stated in the Settlement Agreement for satisfaction of the Funding Condition) setting out:

how that funding is to be provided; and

greater detail in relation to:

the risks being incurred particularly in relation to utilities in the Haymarket to St. Andrew Square section;

the risks surrounding the potential sale or lease of tram vehicles; and

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the extent to which (and how) the Haymarket to St Andrew Square section has been de-risked,

all to enable a fully informed decision to be taken as to the acceptability of that funding;

8.1 (c) Authorise tie Ltd to progress on the priority works, in accordance with MoV4, and incur expenditure within the limits of the project budget of £545m, until the end of August 2011;

8.1 (d) Council instructs the Director of City Development to:

- (i) report back in the autumn on revised governance arrangements; and
- (ii) review and refresh the 'Open for Business' programme in order to improve the focus on support for small and medium sized businesses; and

8.1 (e) As shareholder, ask Lothian Buses to assist in preparing for operations, by accepting transfer of ETL, subject to staff consultation, as soon as possible.

Council also agrees to insert the following clause:

8.1 (f) agrees to begin the procurement of road pavement and public realm improvements for the Picardy Place to Newhaven section of Tram Line 1A with immediate effect, utilising funds which have been set aside in the capital programme for that purpose.

All of this is to ensure the Council is satisfied there is sufficient funding available and that the project has been sufficiently de-risked.

The Settlement Agreement is the agreement to be entered into among CEC, tie and the Infraco to settle existing disputes and set out the revised contractual arrangements to proceed with the works under the Infraco Contract.

It should be noted that the deadline in the Settlement Agreement for satisfaction of the funding condition will be 1 September 2011.

Governance

The report in August will detail the revised governance arrangements, by which the Council will assume direct control of the project through the Chief Executive's

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chairmanship of a Joint Project Forum of the principal parties to the Contract, and the operational leadership of the Director of City Development as senior responsible owner for the project. Tie Ltd will be downsized by around 70% and reduced to a core of technical experts supporting the Council.

The revised governance structure will also ensure the set up of an audit committee to allow political scrutiny of the project. In addition all governance arrangements will follow Prince2 and OGC guidance and respond fully to the recent Audit Scotland interim report.

Financial Assessment

The financial assessment of the project now stands at a cost of between £725m to £773m to complete the project to St Andrew Square.

A lump sum price has been agreed for the off-street section between Edinburgh Airport and Haymarket of £362.5m. The only exclusions to that price relate to artefacts, archaeology and munitions. These risks are thought to be minor.

With regard to the on-street works, there is an estimated cost of £22.5m built into the current cost estimate. The pricing of sub-contractors has been a fully transparent process with both the Infracore contractor and CEC attending tender openings and competitive dialogue with the sub contractors. Tender prices from sub contractors (prior to competitive dialogue) have returned in the range of between £18m-£20m. When agreed, the sub-contractor prices will be aggregated and an agreed overhead and profit fee and preliminaries fee will be added to form the contract price for the on-street section of the works. It is important to note that the on-street contract price will be subject to variation in the event of a departure from certain agreed pricing assumptions or other delay (such as utilities) for which the contractor is also entitled to an extension of time. Detailed rates and prices to be used in calculating any variation to the on-street contract price will be agreed between the parties.

The risk of conflict with unknown utilities remains with CEC. This element will form the biggest part of the risk allowance (breakdown of current risk headings and amounts included below in table 1). It should also be noted that any variation to the on-street contract price could impact on the agreed programme for the off-street works which would give rise to a claim for prolongation costs in respect of the off-street works.

The high end of the cost range to St Andrew Sq of £773mincludes a risk pot of £77m. £30m of this allowance relates to the risk of utility conflicts. It is thought that the construction element of the utilities diversions will be £5m. Currently, site investigation works, including radar scanning and bore holes, are being carried out, in order to give greater certainty to the potential utilities conflict along Shandwick Place. This will enable greater confidence to be established as to the quantum of the risk allowance for these works. This could result in the risk allowance being reduced and hence the overall cost estimate reduced prior to the Council meeting.

In the period to the Council meeting of 25th August 2011, Council officers will be focusing on finalising the funding for the project and also ensuring the budget is as robust as possible, which will include external review and validation.

Risk

Within the £773m the risk element is as follows;

Table 1

		Narrative
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	£m	
Contingency	30	
Utilities Risk	30	Utilities Contract Cost estimated at £5m. Risk allowance primarily for On Street works. This risk allowance may be reduced once trial pits and investigation works are complete.
Event Delay Risk	2	
Third Party Consents Risk	3	
Unexploded Ordinance	0.5	
Post adoption road maintenance	0.5	
Design Completion	10	The completion of the on-street design in the period from now until September should reduce the requirement for an allowance of this amount.
Materials Storage Cost	1.5	
	77.5	

Risk Transfer/Risk Removed

In the period since mediation, the Council has instructed Ashurst (leading UK lawyers in relation to light rail projects) to act on our behalf in the negotiations with the Infracore on revising the Infracore contract under the proposed "Settlement Agreement". As part of this exercise, Ashurst have looked at shifting the allocation of risk within the existing Infracore contract..

In addition, the design for the off street section is now fully complete with the on-street design to be completed by September. This will reduce the potential for scope creep and cost increases associated with design.

Utilities risk is being addressed as set out above.

Confidence in fixed price (covered above)

Remaining uncertainties over price (covered above)

Assessment of the contract management going forward

The Director of City Development will include in the August report to Council, the new governance structure for the project. This will include a change to the contract management arrangements going forward.

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Essentially, the major change going forward is based on collaborative working with the contractor (removing the adversarial approach of the past).

The revised governance arrangements will include;

Joint Project Delivery Group – All heads of discipline from the contractor/CEC/tie will meeting on a fortnightly basis to ensure any issues are resolved around the table.

Joint Project Forum – Essentially this meeting will replace the tram project board and will be chaired by the Council Chief Executive. The forum will also comprise Dr's Keysberg and Schnependahl who are the key decision makers from Bilfinger Berger and Siemens. Any issues that cannot be resolved at the Joint Delivery Group will be escalated to the Forum where a pragmatic decision will be made.

Independent Certifier – With the revised governance structure, there is a role for an independent certifier (who holds a duty of care to CEC) to assess commercial valuations where there is a difference over the amount of certificates and valuations. The Independent certifier will take a fair view of the valuations and payment will be made to the contractor on that basis.

Funding

When it became apparent that the project could not be delivered for the committed funding of £545m the Council were notified of contingency planning up to a level of £600m. This funding came from a mix of funding within the Council's long term financial plan and surpluses from the tram to St Andrew Square. These funding proposals remain.

In addition, the Council has headroom forthcoming within our loans charges budget due to re-financing of borrowing entered into in the early 80's. This would provide an additional £2m per annum which in capital terms could provide an additional £28m.

This would provide £628m in funding and would leave a funding gap of between £97-£145m which would have an impact of between £6.9m to £10.3m on the Council's revenue account.

CEC will also explore the potential for a market to lease/sell surplus tram vehicles (up to a maximum of 10) as a way to defray capital costs.

In the period to the August meeting, the Council will be examining a host of options before presenting the final funding plan for approval.

Whilst recognising it is unlikely that Scottish Ministers will provide further capital grant for the project, it is hoped that there can be dialogue with the Scottish Government to explore a mechanism where the Scottish Government can provide assistance in relation to the Council's borrowing costs.

Due Diligence

In the lead up to the Council meeting on 30th June, there was significant due diligence and validation undertaken by McGrigors and Faithful and Gould in relation to the costing of various scenarios and Independent advice and assessment of the Business Case by Steer Davies Gleave, Buchanans and Atkins.

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Due diligence is being undertaken in relation to utilities risks as set out above.

Relevant Timelines

The Council motion of 30th June authorised the Council Chief Executive to enter into the Settlement Agreement with the Infraco on a conditional basis. This will not become unconditional until the Council confirms to the Infraco in writing that sufficient funding is available to procure that **tie** Limited are able to meet their obligations under the Infraco Contract. The Council will not be in a position to do so until it is satisfied that the budget is sufficiently robust (including external assessment and validation). These matters will be reported back to the Council meeting on the 25th August. If the funding condition is not satisfied on or before 1 September 2011, the Infraco contract will automatically terminate on that date and an agreed sum will become payable to the Infraco by tie.