

## EDINBURGH TRAM PROJECT

### GOVERNANCE, FUNDING, BUSINESS CASE, APPROVALS

Note of meeting between Tie and Transport Scotland 2 August 2007

#### General

1. A letter will go to TA from MR in the next day or two. The content will be consistent with recent senior level exchanges, reflecting the main principles described below. We discussed other follow up documentation and this is captured at the end of this note. In particular, the basis of all new funding will be set out in a New Award Letter.
2. The interests of the Government (shorthand for Cabinet, the Cabinet Secretary, the Executive and Transport Scotland) can be summarised as follows :
  - a. Satisfaction that the Airport / Leith tramline will be delivered
  - b. Confirmation that the BCR is greater than 1.0, now to reflect the world without EARL and any other substantial changes from the Draft FBC (December 2006) ; and
  - c. Confirmation that there will be no Government subsidy requirement for the integrated bus and tram operations.

These are in line with the parameters used to assess the DFBC and are the measures which will be used to determine grant award. Other than general adherence to proper practices designed to protect the public pound, these are the only areas of Government focus. Documentation provided for Government assessment should be limited to material which is directly relevant to these parameters.

#### Governance

3. TS will withdraw from routine monitoring and from the TPB and sub-committees, in favour of the monitoring regime to be summarised in the MR / TA letter and set out in detail in the New Award Letter, in summary :
  - 4-weekly report as now
  - 4-weekly meeting between senior TS people (probably Bill Reeve and Jerry Morrison) and senior CEC people (probably Andrew Holmes and Donald McGougan), others at CEC's invitation including senior Project / tie / TEL people, scope to be only key issues relevant to TS / CEC with no additional reports unless agreed by exception
  - Quarterly TS / CEC CEOs meeting, scope to be agreed but probably focussed on key tram project issues and wider Edinburgh transport matters, at discretion of the two CEOs.
  - Quarterly confirmation from CEC of compliance with New Award Letter terms
4. Satisfaction with governance arrangements planned for the construction period is CEC's responsibility, finalised by approval of the Final Business Case (FBC) which will set out those proposed arrangements.

## Funding

5. Subject to overall agreement on funding terms, the anticipated aggregate grant award will be £500m. There will be no further indexation (up or down). The grant will be available to fund Phases 1a and 1b but strictly on the basis that the whole of Phase 1a must be delivered. A decision to proceed with Phase 1b – whether coincident with financial close or at some future date – is solely that of CEC, but no additional grant award for Phase 1 will be made beyond £500m.
6. There is no Government requirement to future proof the EARL project (or any other project) in designing and constructing the Tram. In the event that the termination of the EARL project results in additional costs or savings to the Tram Project, these will be absorbed within the project budget and will not result in any change to the grant award of £500m.
7. The New Award Letter will reflect all previous grant awards for the implementation of the Tram Project, including the award of £60m approved in Spring 2007 and rollover from prior awards. To assist clarification of certain points below, assume that the total pre-approved funding is £120m, of which £119m has been provided by Government and £1m by CEC. The balance of grant award up to £500m of £381m will be subject to the terms of the New Award Letter.
8. The award of £381m will be on the basis that a proportionate funding mechanism is agreed. This will reflect the balance of commitment of £381m from the Government and the balance of commitment from CEC of £44m. This creates a ratio of 89.65% Government, 10.35% CEC to be applied to all future drawdowns until the aggregate Government funding reaches £500m. All further funding will be to the account of CEC.
9. There is agreement that the bidder terms should be based on cash flow neutrality in their accounts as a means of limiting capital cost bids. Accordingly, the funding from the Government should be scheduled alongside the CEC contribution such that payments can be made to contractors in a manner which achieves cash flow neutrality for the contractors.
10. There may be further advantage if advance sums can be offered to contractors. However, there are public sector accounting difficulties which will need to be addressed if this is to be pursued. DS to organise a meeting with TS Finance people to explore this.
11. Agreed that drawdown arrangements should be kept as administratively simple as possible, consistent with proper control by all parties. Government cannot advance very large sums – eg a full year's estimated requirement – but a quarterly structure should be workable. This will require sound forward estimates of spend and cash flows, reflecting in due course the contractual terms agreed with the successful bidders. The funding for the balance of 2007-08 to Financial Close ("Tranche A" of the new award) is covered below. For the period from Financial Close, using such estimates, cash drawdowns by CEC from Government should reflect an initial drawdown ("Tranche B") of the first

two quarters' funding requirement with subsequent drawdowns to be made quarterly based on the succeeding quarter's requirement. This should provide adequate base funding avoiding a cash shortage. The operation of this mechanism will be monitored quarterly.

12. The drawdowns will require to reflect the proportionate funding arrangement, such that each new drawdown from Government (starting with Tranche A) will be restricted to 89.65% of the full amount required, with the balance to be contributed by CEC. It is recognised that the precise arrangements need further definition to accommodate the mix of cash and in-kind (land) contribution by CEC, but the broad principle should be adhered to by both parties. GB to provide further analysis on this matter. The operation of the proportionate mechanism will also be monitored quarterly.
13. It is recognised that there is likely to be a substantial additional funding requirement in the period prior to Financial Close beyond the funding currently in place. This was previously estimated at c£60m and reflects continuation of the current programme, including land acquisition and utility works. Although programme slippage arising from the post-election period has moved some cost forward, the sum involved remains substantial. GB to arrange an up to date estimate. DS noted a risk that Government may not be willing to provide further funding prior to financial close, which would have extremely damaging consequences for the project. The solution lies in the progress made through procurement, preparation of FBC and in the commitments given by CEC – see below under approvals.
14. CEC and tie are examining options for leasing and debt arrangements to support overall funding. These may prove to be financially efficient and carry other advantages. The scope of these arrangements is focussed on incremental funding for Phase 1b, but it may transpire that there is advantage in extending the facilities to encroach on Phase 1a. In the event that there is demonstrable advantage to all parties, CEC and Government will engage in good faith to conclude on appropriate action, most likely in 2008.

#### Approvals involving Government

15. The summary of the proposed top-down programme is attached. Now anticipates substantially complete FBC (Version 1) to accompany Preferred Bidder recommendation and draft New Award Letter (which includes Tranche A funding) going before full Council on Sept 27<sup>th</sup>. Careful project management should allow TS IDM to approve same on Oct 10<sup>th</sup>, followed by full council approval on Oct 25<sup>th</sup> and Cabinet approval in week beginning Oct 29<sup>th</sup>.
16. Assuming finalisation of contracts and all related documentation is achieved in line with September Documents over the period Nov / Dec, full Council to approve on Dec 20<sup>th</sup> and mechanism to be established to achieve Government approval on Dec 21<sup>st</sup>. Actual award and contract completion on Jan 11<sup>th</sup>.

17. Scope of Gateway 3 to be in line with standard OGC guidelines and to be agreed in advance with TS. Report to go to IDM Board Oct 10<sup>th</sup>, all subsequent approvals dependent on all “red, hold” issues being resolved.

#### Final Business Case

18. Agreed that FBC should be DFBC amended only as necessary. Specific points to update are embedding of the no-EARL scenario as base case, reflected also in BCR calculation (work already substantially executed in support of DFBC) ; and revised capital costs based on preferred bids.
19. TS comments / tie responses on DFBC to be embedded in FBC, understood not to be fundamental, no further iterations or reporting & debate with TS needed on these matters.

#### Contingencies

20. Recognised that desire is for a straight-forward arrangement between CEC and Government ; however, certain contingencies cannot be accepted unqualified by CEC in view of scale of financial risk relative to CEC resources :
  - a) Action taken by the Government which leads to a material extension of programme or increase in cost - incremental costs to be met by Government
  - b) Government determines not to support the project at some stage in the future resulting in termination costs – all termination costs and CEC sunk investment to be reimbursed
  - c) Network Rail frustrate progress of project through immunisation (or other) arrangements – Government will not underwrite this risk, but will enter into best endeavours agreement to support CEC in dialogue with NR. CEC / tie / TEL to consider whether risk is acceptable and process manageable.
  - d) Other third party involvement – BAA plc, HMRI, HSE, other – needs further consideration ; CEC foresee potentially unacceptable risk balance and need to address further.
21. Dispute resolution process to be embedded in New Award Letter covering inter alia failure by either party to meet payment obligations,
22. Mechanism required to protect CEC / TEL from Government action which affects materially the operational performance of the integrated bus and tram system, for example substantial financial support for Son of EARL (Tram disruption and revenue attrition).

#### Documentation required

23. MR / TA letter to be issued imminently, cc'd to Chairs of TEL and tie
24. Distilled version to be available by mid-August for public consumption (mainly for bidders to reinforce confidence)
25. Draft New Award Letter is being prepared by TS, to be finalised by end-August at latest.

## **Other matters**

- 26. Government is neutral to asset ownership, corporate structuring and related matters which are CEC's prerogative so long as within bounds of normal public sector good practice.**
- 27. Certain aspects of 4-weekly reporting require further discussion : construction period programme requires to be cost-loaded at a sensible level of detail and will be basis of cash flows which support drawdown ; timing of submission to be re-addressed with objective of bringing forward by one week to align with other TS projects, again probably effective construction commencement.**
- 28. FBC to reflect same assumptions about concessionary fare support as in DFBC. Government position is that parties should be "no better and no worse off".**

## **Next steps**

- 29. DS / GB to agree this note, discuss issues within respective organisations.**
- 30. Follow up meeting asap between GB / DS and Donald McGougan. GB to organise.**

## APPENDIX

### Top-down programme

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 [Done, currently under refinement]
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 "September Documents" : 1) FBC V1 2) preferred bidder recommendation 3) draft New Award Letter including Tranche A funding
Sept 20 <sup>th</sup>	September Documents submitted to TPB
Sept 27 <sup>th</sup>	TPB approval (and recommendation to TEL Board / CEC) of same [preferably alongside draft report to Council].  Submission of September Documents to CEC Officials and extracts submitted to Government (prior review preferable and to be planned)
Oct 1	Contracts for additional advance works entered into, conditional inter alia on termination without adverse cost in event that CEC / Government do not approve FBC V1, Preferred bidder recommendation and / or Tranche A funding within New Award Letter.
Early Oct	Gateway 3 review, confirmation to TS on critical issues
Oct 10 <sup>th</sup>	TS IDM reviews / approves September Document extracts, plus update on Gateway 3
Oct 18 <sup>th</sup>	Report and supporting documents circulated in advance of full Council meeting on .....
Oct 25 <sup>th</sup>	Full council meeting to approve FBC V1, Preferred bidder recommendation and draft New Award Letter
Oct 29 <sup>th</sup>	Cabinet approval of September documents including New Award Letter / Tranche A funding

<b>Nov / Dec</b>	<b>Completion of all contractual and funding documentation, update to produce FBC V2, official level approval by all parties</b>
<b>Dec *</b>	<b>TPB approval, recommendation to TEL Board / CEC (*date may need revised)</b>
<b>Dec 20<sup>th</sup></b>	<b>Report to full Council, which should reflect only marginal changes to form agreed in October ; full Council approval</b>
<b>Dec 21<sup>st</sup></b>	<b>Government sign-off conditional on all other aspects of financial close (mechanics of sign-off to be addressed)</b>
<b>To 11<sup>th</sup> Jan</b>	<b>Finalisation of documentation, final negotiation etc</b>