



CORPORATE FINANCE

Edinburgh Tram Network

Interim Outline Business Case

ADVISORY

AUDIT ■ TAX ■ ADVISORY

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Key Points

- The City of Edinburgh Council have made clear that they will not fund the project or take either construction cost or significant revenue risk
- **Tie** has no ability to take risk itself, and no internal sources of funding
- So the Scottish Executive is at present the only funder, and is *de facto* taking all the project risk

- The Bill before the Scottish Parliament are for Lines 1 and 2, including the Newbridge Spur
- The IOBC states that a network of Lines 1 and 2 together is not affordable within the £375 million limit on Scottish Executive funding. There is a gap of over £200 million
- The current project is not affordable on the current funding

- **Tie's** procurement strategy breaks the project down into a number of separate contracts – design, utilities, rolling stock, construction and systems and operations
- Such a procurement strategy can be effective, but it requires a public sector party that can manage interface issues – and absorb the risks around them
- Contingency/risk allowances within the current plan are low at around 10% - with some sensitivity analysis of higher optimism figures
- **Tie** may be able to manage their disaggregated strategy, but they will need to have access to additional contingency funds

Governance

- **Tie** is a stand alone limited company, owned by the City of Edinburgh
- It is promoting a number of projects in and around Edinburgh:
 - **The Edinburgh Tram Network**
 - **The EARL project**
- The current governance structure for the Tram Network involves **tie's** management, the City of Edinburgh and the Scottish Executive – operating through a project board and management committees (e.g. for change control)
- But at present only the Scottish Executive is providing funding, or taking risk, for the tram project
- So the Scottish Executive should have control of the project development, and the ability to set incentives for the project's management team. While the City should be closely involved and consulted, its councillors and officers should not be in a position to take decisions
- Implementing this might require a separate Tram Network company, perhaps within the Transport Agency

Scheme size and affordability

- The Parliamentary Bills for Lines 1 and 2 will be further considered in detail this autumn.
- Current costs for Lines 1 and 2 suggest a shortfall of £206 million including the Newbridge Spur, and £152 million excluding Newbridge, against current funding of £375 million
- Line 1 would be affordable on its own, even allowing for a more realistic level of optimism bias. Line 2 is more marginal
- **Tie** are currently working on options which mix parts of Line 1 and Line 2 (for instance Ocean Terminal to Edinburgh Park via Haymarket. A rough analysis suggests that it might be appropriate to build more than just Line 1 within £375 million; there can also be a release of contingency monies once the scheme is operational, which will allow for an additional extension; but operating surpluses are unlikely to fund further major extensions to complete the network in the Bills
- The current funding of £375 million is not indexed. This provides an incentive to spend it as quickly as possible, and may not offer best value for money
- The project that is taken forward should broadly match the funding that is available. Large funding gaps can lead to pressure to adjust budget numbers; and if budget numbers lose credibility, there can be serious value for money effects
- **Tie's** work on phasing is important, and should be considered carefully
- The phasing should be chosen so that there is flexibility within the budget limit. If there is a large funding gap, the scheme should be reduced in scope as quickly as possible
- The Executive should consider indexation arrangements for £375 million to encourage **tie** to adopt procurement and financing approaches that are value for money

Procurement strategy

- **Tie's** procurement strategy breaks the project down into a number of separate contracts – design, utilities, rolling stock, construction and systems and operations
- The contract has been let for operations (DPOFA), and contracts are being let for design (SDS) and technical support (TSS)
- Both DPOFA and SDS contracts are flexible, and the work planned for 2005 seems reasonable
- Carrying out some utilities work in advance is now seen as good practice
- There is an issue over how design work is controlled to minimise cost within the sensitive Edinburgh environment. The Scottish Executive is now the only funder
- The approach to rolling stock procurement will complicate the procurement process and introduces some significant interface issues. **Tie** will have to manage those issues – and absorb the risks around them.

- **Tie** is likely to need an additional contingency budget for this, or a retention of part of the £375 million as contingency/risk/optimism allowances within the current plan are low at around 10%
- The Scottish Executive should be fully involved on the further work on the vehicles procurement strategy and on the financing options