

Mr John Swinney MSP
Cabinet Secretary
The Scottish Parliament
EDINBURGH
EH99 1SP

Our Ref: data\tramsproject\swinn01

Your Ref:

Date: 5 July 2011

Acting Cabinet Secretary

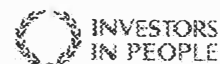
As you may know the City of Edinburgh Council on Thursday 30 June 2011 conditionally approved recommendations to complete the first phase of tram line 1a from Edinburgh Airport to St Andrew Square/York Place. For clarity, the recommendations, as amended are shown in full below:

- 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:
 1. the risks being incurred particularly in relation to utilities in the Haymarket to St. Andrew Square section;
 2. the risks surrounding the potential sale or lease of tram vehicles;and

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Sue Bruce, Chief Executive

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3. 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.

Regarding the revised governance arrangements set out in 8.1(d) (i) of the Council motion, the report in August will detail the revised governance arrangements, through which the Council will assume direct control of the project through a Joint Project Forum involving the principal parties to the Contract which I will chair, and the operational leadership of the project through the Director of City Development as senior responsible officer. **tie** Ltd will be downsized by around 70% and reduced to a core of technical experts supporting the Council. The **tie** brand will disappear, although it is intended that Vic Emery, **tie** Chair will continue to have an active role in the Joint Project Forum.

My purpose in writing to you at this stage is to let you know the extent to which the Council believes it will be possible to fund the project from its own resources and to highlight the gap for which we believe support will be needed from external sources.

The costs of the St Andrew Square option have been carefully estimated to be £773m. This figure includes a risk reserve of up to £77m which we are working to reduce as details of ground conditions in the Haymarket to St Andrew Square section become better understood, following utilities scanning and the completion of trial bore holes.

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The Council previously had prepared contingency plans to secure a further £55m to support the project. This funding is available through a combination of headroom in the Council's capital programme and revenues generated through tram operations to St Andrew Square. The Council may also be able to provide additional funding through the refinancing, over the next three years, of expensive loan charges taken out during the 1980's at interest rates of up to 15%.

We also believe it will be possible, with some confidence to capitalise the revenue that the Council currently receives as a dividend from Lothian Buses. The Council has planned for a dividend of £2m per annum from Lothian Buses, though it is thought that an additional £1m could be generated from the Lothian Buses dividend which would raise an additional £14m in capital terms. There may also be the opportunity to lease the infrastructure and tram vehicles to Lothian Buses, this could replace the current dividend and provide additional tax benefits to Lothian Buses. This is a potential avenue that is currently being examined.

We have additionally modelled that up to £25m could be raised from the sale or leasing of surplus trams. This has to be regarded with some caution as the market for this option is not yet fully tested and that is a work in progress.

Taken together, the above measures would enable the Council to raise a total of £650m towards the overall project costs leaving a residual gap of around £100-£125m.

I recognise that capital funding support is exceptionally difficult in the current funding environment and that the Scottish Government has made its position very clear on this matter.

Prudential borrowing will almost certainly provide the lowest cost solution to the current funding gap. At present the Public Works Loan Board rates stand at 5.29% for 30 year borrowing.

It would be of benefit to The City of Edinburgh if you could consider an adjustment to the way we treat income from non domestic rates.

Our target for the current financial year is £297.4m. I understand that discussions are continuing between COSLA and Scottish Government officials on the basis of a 50:50 sharing of any income in excess of individual authorities' targets.

It would be beneficial if the Scottish Government could consider allowing Edinburgh to retain 100% of any figure above the current target which could then be used as a potential source of funding for the borrowing costs on the tram project.

Clearly it would be beneficial that the adjustment to the Council's baseline be made for the period of the repayment of any borrowing for the project.

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These potential solutions, or a suitable and mutually workable variant would enable the Council to manage the remaining funding gap without compromising its existing capital programme commitments which include £487m of investment over the period from 2011-2015 and key projects including:

- the refurbishment of the Royal Commonwealth Pool which includes the diving facility for the 2014 Commonwealth Games;
- the £80m extension of additional function and exhibition space at the EICC which is important to the Scottish economy particularly in terms of business tourism;
- the new Portobello High School;
- the refurbishment of the Assembly Rooms; and
- the Water of Leith Flood Prevention Scheme.

The arrangement would also avoid currently committed future capital projects such as the new Boroughmuir High School and James Gillespie High School being placed at risk.

I fully appreciate that, given the stated position of the Scottish Government on the tram project, this request is not necessarily an easy one. However, I am confident that through partnership with the Scottish Government, Transport Scotland and potentially the Scottish Futures Trust the Council will be able to deliver line 1a from Edinburgh Airport to the City Centre by 2013 and see the first trams running on test track at the Gogar Depot before the end of the current calendar year.

I would very much appreciate an early meeting to discuss further the decision of the Council and to explore the potential solutions which lie ahead.

I look forward to hearing from you.

Yours sincerely



SUE BRUCE
Chief Executive