

Edinburgh Tram – Update on Financial Close

Tram Sub-Committee

16 June 2008

1 Purpose of report

- 1.1 To notify the Tram Sub-Committee about the Financial Close of contracts for the Edinburgh Tram Network (ETN).

2 Main report

- 2.1 A report updating the Council on the imminent completion of the contractual negotiations for the ETN was submitted to Council on 1 May 2008. Delegated authority, awarded to the Council's Chief Executive by the Council on 20 December 2007, was refreshed to allow tie Ltd to enter into contracts to deliver the ETN, subject to suitable due diligence and provided that any remaining issues were resolved to the Chief Executive's satisfaction.
- 2.2 A further B Agenda report was provided to the Policy and Strategy Committee on 13 May 2008 to approve the final estimated cost for the ETN, to authorise tie Ltd to enter into contracts with the Infracore and Tramco bidders and to refresh the Chief Executive's delegated authority to make any final, minor amendments in respect of the contracts.
- 2.3 The contracts are now concluded and signed. The final terms differ from those anticipated in the Chief Executive's report to the Council on 1 May 2008 in that the estimated capital cost for phase 1a now stands at £512m with a further contingent payment of £3.2m due, if phase 1b is not built. This figure is well within the available funding of £545m.
- 2.4 There is no change to the planned date for commencement of fare paying services in summer 2011.

Recent Developments

- 2.5 It was reported to the Council on 1 May 2008 that, during contract negotiations, underlying costs were subject to the conversion of provisional prices to fixed sums, currency fluctuations, inflationary pressures and the transfer of risk to the private sector. The finalisation of the contracts required further amendments for similar reasons.

- 2.6 Since then, **tie** Ltd has continued to work to ensure the competitiveness of the developing contract terms so that these continue to represent best value and are fully aligned with relevant regulations, culminating in Financial Close on 14 May 2008. Offsetting the increase in cost is a range of negotiated improvements in favour of **tie** Ltd and the Council in order to reduce the risk of programme delays and minimise exposure to additional cost pressures, as well as better contractual positions.

Capital Cost and Quantified Risk Allowance

- 2.7 The estimated capital cost of phase 1a, as reported to the Council on 1 May 2008, was £508m, consisting of base costs of £476m and a Quantified Risk Allowance (QRA) of £32m.
- 2.8 Following the introduction by the contractors of additional cost pressures late in the due diligence process, **tie** Ltd held negotiations with them to substantiate its requests for contract price increases and to seek to limit the increase. To help reduce the risk of programme delays, the price increase agreed will be paid as a series of incentivisation bonuses over the life of the contract, on achievement of specified milestones. This approach should minimise the risk of delays to the agreed programme of works to businesses and residents of Edinburgh. These changes increased costs by £4m to £512m consisting of base costs of £481.8m and a QRA of £30.2m. The cost increase has resulted in transferring further risks to the private sector. In addition, part of the package negotiated entitles the contractors to an additional payment of £3.2m, should the Council decide not to construct phase 1b of the tram network. This would result in a final estimated capital cost of £515.2m should phase 1b not proceed.

Benefits of the final deal

- 2.9 In return for the financial amendments, **tie** Ltd has secured a range of improvements to the contract terms and risk profile.
- 2.10 The improvements to the contract terms and risk profile are:
- Immediate contract close on preferred terms
 - Elimination of risk of claims arising from works underway
 - Capping of road reinstatement cost exposure
 - Capping of roads related prolongation
 - Entry of Construcciones y Auxiliar de Ferrocarriles SA (CAF - the Tram Vehicle Supplier) into the Consortium

In summary, the late price pressure has been contained at £4m as a result of the items noted above. These additional costs have been offset, in part, by a reduced risk exposure. A further agreement has also been established that **tie** Ltd and the Council will underwrite contingent Phase 1b demobilisation costs of £3.2m if Phase 1b does not proceed with the contractors.

Alternatives Considered

- 2.11 The very late increase in contract price was clearly undesirable, although an evaluation of the revised proposal concluded that it continued to represent the best option in terms of price, programme and quality. All other options considered would have resulted in extending the time period for financial close by at least three months and so any potential commercial advantage would be more than offset by inflation, additional procurement costs and **tie** Ltd's own running costs, as well as delaying the commencement of revenue generation from the trams.


3 Financial implications

- 3.1 The estimated final cost for phase 1a of the Edinburgh Tram Network of £512m, with a further contingent payment of £3.2m due, if Phase 1b is not built, remains well within the agreed funding envelope of £545m.
- 3.2 While the process to reach Financial Close has been longer than anticipated, the final terms are within 2.8% of the Final Business Case estimate of £498m and 0.8% of the estimated cost reported to the Council on 1 May 2008 (provided that phase 1b is built). It is, therefore, considered that the contract terms continue to represent the best value delivery option.

4 Recommendations


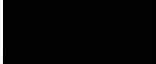
- 4.1 It is recommended that the Tram Sub-Committee:
- (i) notes Financial Close on 14 May 2008 and the updated position on the suite of contracts for the Edinburgh Tram Network.
 - (ii) congratulates all the staff of tie Ltd, TEL and the Council involved in the negotiations which led to Financial Close.


Dave Anderson
Director of City Development


Donald McGougan
Director of Finance

4th June 2008

Appendices None

Contact/tel Andy Conway 0131 
 Alan Coyle 0131 

Wards affected All

Background Papers None