Annexe A – further questions

Reference is made to the appropriate paragraphs of the promoter's response.

Future costs
The Committee's report asked for details of the funding that is likely to be generated from private sources, and what has been secured. **The Committee does not feel that this request has been adequately answered.**

1. **Paragraph 7.1.1:** Can clarification be provided as to why it was not considered appropriate for inflation to be included in the original cost estimates, given that subsequently adding this would lead to a perception that costs have risen?

It has become standard practice to present the cost estimates on publicly funded projects in base dated prices, in the case of the Tram project Q2 2003 prices. There are probably many reasons why this is the case – probably foremost being the inherent uncertainty in forecasting inflation compared to estimating costs based on historical price data and the difficulty in estimating an inflated cost estimate in the absence of a reasonably certain timetable for the project. It is indeed unfortunate that this leads to a perception that costs have risen as it has done on more than one project. **tie** has maintained inflated cost estimates in parallel with the base dated cost estimate from the outset – at the preliminary stage the Committee's advisors (Ove Arup) examined the inflated cost estimates for Line 2 which subsisted at that time.

2. **Paragraph 7.1.2:** Presumably, the allowance for an inflation rate of 6% reflects the current inflation rate in the construction industry?

The rate of 6% reflects tie's prudent judgement of the historical and forecast impact of inflation over the period of the project. In arriving at this overall rate, tie has taken into account the particular inputs to the work such as steel where there has been a relatively high level of inflation since 2003. In arriving at this judgement historical industry inflation indices have been fully taken into account.

[Drafting note – I am content with this answer. You should be aware that analysis we have seen suggests a figure lower than 6% but there is no need to get into that before the Committee.]

3. **Paragraph 7.1.2:** Does the "total inflated cost estimate" include likely inflation up to the actual date that the project is completed?

Yes. The inflated cost estimate is a nominal figure i.e. it represents the forecast outturn expenditure when the project is complete.

4. **Paragraph 7.1.4:** If the Treasury's requirements are for an optimism bias of 24%, why did the promoter assume a specified contingency of approximately 10%?

Optimism Bias was developed by the Treasury as a means of mitigating against the tendency to underestimate the capital cost of public works. tie has always considered that because the cost estimates for the Tram project are well developed and are in most part based upon the outturn costs on similar projects, the specified contingency of 10% advised by our technical advisors will be adequate to deliver the project in the absence of any significant changes to the scope of the project or the timetable for its completion. We would anticipate that the calculation of optimism bias under Treasury guidelines will fall to 10% or less once the tenders for the main infrastructure works have been received in the autumn of 2006.

5. **Paragraph 7.1.4:** "The extent to which this contingency proves to be necessary will be dependant upon the number and value of changes to both scope and programme...". Can any indication be provided of the likelihood of all these contingencies being required?

tie anticipates that any requirement to increase the specified capital cost of the project including out 10% contingency would be a result of significant changes to the scope or timetable for the project as now before the Committee. A significant scope change could arise for example from:

- A change in the level of service on the Tram – e.g. imposing a speed limit might necessitate additional infrastructure and vehicles to maintain the same level of service.
- Change in the quality or extent of materials used in its construction – e.g. a lower noise limit might necessitate additional costs to implement.
- Significant new costs such as enhanced compensation provisions.

A significant timetable change could be the result of an unexpected delay in progressing the project through the various approvals such as Parliamentary assent, funding approval, planning consent and traffic regulation orders. An effective governance regime has been put in place whereby potential or proposed changes to either scope or timetable are identified and the cost consequences of such are understood by all stakeholders and mitigating actions taken.

6. **Paragraph 7.1.4:** What are the consequences for the financial viability of the scheme if the Scottish Executive and the CEC decides that there should be "visible funding" in respect of this additional contingency?

The strategy now being followed is that CEC and SE will not make a final determination on funding until after the initial tenders for the main infrastructure and vehicle contracts have been received in the autumn of 2006. As explained in the answer to Q4, at that time we will have a degree of certainty with regard to the final cost the project such that the level of optimism bias required under the Treasury guidance should have fallen to a level at or below tie's specified contingency.

7. **Paragraph 7.2.1:** What indication has the Scottish Executive given that it is committed to funding costs associated with inflation? If the grant is not indexed, how would the shortfall be met?

SE have indicated they are considering the question of indexing. The sequence of events now being followed is that SE and CEC will agree upon a total funding package with the benefit of the initial tenders for the infrastructure and vehicle contracts in the autumn of 2006. At that time the decision making process will also be informed by a further enhancement to the appraisal of economic costs and benefits of the Tram system, comprising Lines 1 and 2, operating as network and the revenues and costs of operating such a network. There is good reason to believe that that this further information will give SE the justification in terms of value for money for increasing their grant in line with inflation. If the grant were to remain fixed at £375m then CEC and tie would consider the options, facilitated by the terms of the tenders for the main infrastructure and vehicle contracts, to deliver Lines 1 and 2 in a phased manner providing always that each phase so delivered represented value for money in economic terms and a high probability of generating an operating surplus in its own right.

8. **Paragraph 7.2.2:** Can more detail be provided of the likely contribution that will come via the four sources identified in this paragraph? If full funding does not materialise, are there likely to be council tax rises or any other charge imposed by the council to cover the shortfall?

It is not CEC's intention to make contributions towards the capital costs of the Tram network which cannot be met out of future tram related receipts. It follows that it is not CEC's intention to meet any funding shortfall out of general CEC revenues or from council tax rises. The total value of CEC's cash contributions to tram development costs together with the value of land contributed (including S75 agreements) and reasonable certain development contributions can be reasonably expected to total £25m in inflated terms. The potential for further CEC receipts from developers' contributions, other property related development and the operation of Lines 1 and 2 are significant but still subject to uncertainty and CEC must determine a prudent level of borrowing or similar means of committing to a cash input to the project in 2006 to 2010 which will be met by those future uncertain receipts.

CEC and tie will continue to examine these potential future income streams and the risks associated with them in the period up to the agreement between SE and CEC on the final funding package available for the project.

9. The figures provided throughout paragraph 7 deal with capital costs; please specify whether there have been any changes to current costs and whether these are likely to impact on capital costs.

The business case analysis conducted by tie and its advisors reflects no significant changes to the forecast operating costs of Line 1, Line 2 or both lines combined and that in each case there is a high probability of generating an operating surplus in relation to the existing revenue forecasts.

Phased Implementation

10. **Paragraph 7.1.2** provides an illustration of the total cost if the Newbridge section is delayed; are there are any other parts of the line 2 network that could be delayed and, if so, have the likely savings been calculated?

Further options have been identified for delaying sections of Line 2 and of Line 1 and the potential capital costs which would be deferred by doing so. However there are a number of other factors which must be further developed prior to any decision to defer any part of Line 2 to a later phase including:

- The construction market's view of the risks they will bear and therefore their price for constructing each section of Lines 1 and 2 – this will be much clearer when initial tenders have been received for the infrastructure contract.
- The optimum operating parameters for each network configuration – Newbridge is easier to isolate in this regard but e.g. not building Line 2 at least to the depot site at Gogar has implications for the operation of Lines 1 and 2 as a network and for the capital costs of doing so.
- The implications for patronage and revenues of delaying further sections of Line 2 to later phases – e.g. airport patronage is a significant part of Line 2 patronage projections.
- Completing Line 2 to the airport has strategic significance in the context of Edinburgh's longer term development.
- The extent to which public transport demand could and should be effectively met by other means (e.g. buses) in the event of further phasing.

In essence, the economic and business case appraisals for Lines 1 and 2 in isolation remain valid but SE and CEC wish to examine comparative economic and business case appraisals for different phasing options before committing to the funding package for the first phase of a network of both in late 2006.

11. **Paragraph 1.8:** is it likely that profits from property developments and tram operating profits will cover the Newbridge shortfall?

As noted above, CEC will make a prudent determination of the level of funding for Lines 1 and 2 they can commit to at the outset having considered potential future income from developers' contributions and operating surpluses from tram. There are still uncertainties with regard to these sources of income which make it difficult to conclude whether they will be sufficient to complete Newbridge or any other part of Lines 1 and 2 which may or may not be delayed beyond the first phase. **tie**'s preliminary analysis is the developers contributions over the life of the tram could be very significant if and when CEC's development aspirations for Edinburgh materialise. What is clear from the current projections is that the Newbridge section on its own would make an operating loss until the development of west Edinburgh delivered the patronage necessary to eliminate the need for subsidy from surpluses generated elsewhere.

12. **Paragraph 7.2.3:** if the Newbridge section were to be deferred – bearing in mind the possible blight on affected parties – how long is it likely to be deferred for?

The pace of development in the entire Rural West Edinburgh is such that any interregnum is likely to be relatively short-lived. Emerging proposals for major housing development, new strategic commercial development and the expansion of Edinburgh Airport will offer significant opportunity for developer led and leveraged funding.

13. Does the promoter envisage that the Newbridge – or any other – section may not ever be built?

It remains CEC's intention to complete the whole of Lines 1 and 2 when funding becomes visible to do so. There have been no changes to CEC's development aspirations for the west of Edinburgh or the benefits and aspirations identified in the STAG appraisal for Line 2 which would lead to a different conclusion.

14. The Bill provides the power to acquire land 5 years from the Bill becoming an Act, but this time limit may be extended. Does the promoter still feel that this period should not be extended beyond 15 years (as discussed in the Subordinate Legislation Committee report)?

The Promoter is content that the general powers to acquire land need not extend beyond 15 years. However, in that the financial position (and therefore the need, or otherwise, for phasing) will not be known until Autumn 2006, it would be prudent and helpful to include specific powers within the Bill(s) to allow extension of the powers in respect of the Line 2 route from Ingliston to Newbridge (and the Ocean Terminal to Granton Square section of Line 1). These specific powers could permit extension of the powers by Scottish Ministers for a further five years.