

Edinburgh Tram Update Report

City of Edinburgh Council

14th October 2010

1 Purpose of report

- 1.1 The purpose of the report addresses the motion from 24th June 2010 Council which requested a separate report outlining a refreshed Business Case detailing the capital and revenue implications of all the options currently being investigated by **tie** and taking into account assumptions contained within the original plan (eg anticipated development) that either no longer apply or whose timescales have now substantially changed.
- 1.2 The report also provides updates on the recent contractual negotiations on the Edinburgh Tram Project and an update on the governance arrangements.

2 Main report

Tram Business Case Refresh

- 2.1 The refresh of the Business Case was instructed by the Council on 24th June 2010. Its purpose is to refresh the assumptions made in the Final Business Case (FBC) for Phase 1a of the Edinburgh Tram Project, as approved by the Council in October 2007.
- 2.2 The Council's instruction is set against a backdrop of commercial disputes with the infrastructure contractor, which have resulted in significant programme slippage and increasing project costs. In addition, the difficulties with the contractor have come at a time of economic downturn which has had an impact on the original planning assumptions.
- 2.3 The outputs of the refresh of the Business Case result from a significant amount of work carried out to reassess the assumptions underlying the FBC and are informed by the recent commercial experience of Lothian Buses.
- 2.4 In addition to the contribution of **tie**, Lothian Buses' management have been fully involved in the refresh of the TEL Business Plan. These inputs contain commercially sensitive information on patronage assumptions for buses as well as trams and consequently the detailed figures must remain commercially confidential. There has also been considerable work done by consultants Steer Davies Gleave and Colin Buchanan, providing independent input to model the revised patronage assumptions.

- 2.5 The refresh of the Business Case has primarily focused on updating the economic case for Phase 1a; incremental delivery; and updating of the TEL Business Plan (taking into account the revenue impacts of incremental delivery; investment to date; and funding and affordability).

Consideration and Assessment of Incremental Delivery

- 2.6 Due to the cost and programme difficulties experienced on Phase 1a there has been a requirement to consider completion of Phase 1a in incremental stages as a contingency measure. The main focus of incremental delivery would be to deliver Airport to St Andrew Square as the first phase.
- 2.7 The phased delivery of the project would provide the opportunity to manage key affordability risks through incremental delivery of the on-street sections. This approach would ensure that investment in the project is realised by the delivery of a viable tram service, integrated with bus services, whilst preserving the entire scope of Phase 1a, as detailed in the FBC.
- 2.8 Incremental delivery would allow the whole of Phase 1a to be delivered in stages and over a flexible timescale under the Council's control. The Council could then ensure that the infrastructure being delivered, at any point in time, is matched with available funding.
- 2.9 A first incremental opening of tram services from Airport to St Andrew Square would yield early economic and integration benefits, provide an enhanced transport link between the city and Airport and a rail link to other areas of Scotland as a result of the interface with the Edinburgh Gateway Project (Gogar Station). A tram operating from the Airport to St Andrew Square would also secure a high proportion of the economic benefits anticipated in the FBC and is capable of being successfully integrated with Lothian Buses' operations.
- 2.10 One of the key considerations under the incremental delivery option is to evaluate whether the potential first phase of construction to St Andrew Square is capable of delivering a positive contribution to the TEL business.
- 2.11 The evaluation of incremental delivery has shown that the TEL business, as a whole, is stronger in the medium to long term with tram added to the existing bus business, even if the tram is only operated between the Airport and St. Andrew Square. The key outputs from the TEL Business Plan are highlighted later in this report.

Updating the Economic Case for Phase 1a

- 2.12 An update of the economic case for tram has addressed both the full scope of Phase 1a and the option of incremental delivery.
- 2.13 The review of the economic case for tram refreshes the patronage sources and growth drivers in the city, taking into account a review of development profiles for Leith, the City Centre and West Edinburgh and assesses the impact of the development of the Airport and the broader regional drivers such as Gogar Station and the Edinburgh-Glasgow Improvement Plan. The update also looks at the longer term context of the Council's Transport 2030 vision and modal

shift away from private car that is a key policy driver for the Council and Transport Scotland.

- 2.14 The need for tram has been examined against the wider context of Edinburgh's short, medium and long term strategic position.
- 2.15 Edinburgh's population is currently expanding by around 1% per annum and is forecast to reach 514,000 by 2020 and 543,000 by 2030. As significant, the volume of commuters coming into the city to work from the surrounding city region and further afield was estimated at 85,000 per day at the 2001 census and is now around 100,000 per day and growing.
- 2.16 The city's growth has led to rapidly increasing demand for road use and increasing demand for public transport. Between 2000 and 2009, Lothian Buses patronage growth has been 18.9% in total, which equates around 2% per annum.
- 2.17 Tram is, in itself, considered to be a key stimulant to economic regeneration and new development. The extent of new development forecast is lower than was anticipated when the FBC was prepared in 2007 as a result of the economic downturn. With the key input of Council planning officers, an update of the likely timing of committed new development has been undertaken.
- 2.18 It should be noted that the revised development profile only comprises committed developments or developments that have achieved outline planning consent and as such is considered prudent.
- 2.19 Whilst the residential development in the North of the city and in Leith completed at commencement of tram operations is projected to be more restricted than originally anticipated, the Council is forecasting a recovery such that, by 2012, 30% of the original forecast will be completed, 80% of the original forecast will be completed by 2020, and by 2031 the residential development in North Edinburgh will have recovered and the original development forecast will apply. The forecasts broadly anticipate a 4-5 year period of very slow development as a result the economic downturn, following which a return to growth will prevail.
- 2.20 It is clear that whilst the impact of the recession on the pace and size of development in the city has been significant, most notably at the Waterfront, it is important to consider the longer term view. The tram remains an important stimulant to development and regeneration in the West and North of Edinburgh.

The TEL Business Plan

- 2.21 The update of the TEL Business Plan is the key output from the updated economic case for tram. The primary area under examination is the revised patronage and profitability forecasts for Phase 1a in total and the assessment of the impact of incremental delivery on TEL. In addition to the revised development assumptions, the updated forecasts for TEL are also built on the recent experience of Lothian Buses and further patronage modelling by external consultants, Steer Davis Gleeve and Colin Buchanan. These forecasts have been profiled against incremental delivery to St Andrew Square to assess the impact on the TEL business. As mentioned previously, these

inputs contain commercially sensitive information on patronage assumptions for buses as well as trams and consequently the detailed figures must remain commercially confidential.

- 2.22 As part of the preparation of this refresh, a review of the key assumptions and projections for the TEL Business Plan has been undertaken. This review has confirmed the validity for the whole of Phase 1a. It has also confirmed that the operation of incremental delivery of Phase 1a from Airport to St. Andrew Square is sustainable and has a positive impact on the TEL forecasts in the medium to long term.
- 2.23 The approach to integration of the key local public transport modes, bus and tram, sets Edinburgh apart from other UK tram schemes. The integration of high quality bus and tram services will improve the attractiveness of the combined network to something greater than the sum of its constituent parts. The levels of demand projected by the transport modelling, undertaken by Steer Davies Gleave and Colin Buchanan, indicate a significant profit potential for TEL operating with the tram in the medium to long term.
- 2.24 The key conclusions relating to the profitability of revenue running from the Airport to St Andrew Square are;
- TEL as a whole will be profitable from year one of operations.
 - Tram will be profitable following an initial three year period of patronage build up.
 - The business will experience significant growth in profits in the longer term.
- 2.25 In addition, significant work has been undertaken to assess positive and negative sensitivities in the business plan assumptions in the early years of tram operation. This analysis will inform management to allow action to be taken to ensure the profitability of TEL remains intact. The sensitivities examined included patronage, electricity, fuel, labour and yield. It should be noted that another key sensitivity is in relation to the application of the Concessionary Fares Scheme. Discussions with Transport Scotland have indicated that the business planning assumption should continue to be that the Concessionary Scheme should continue to apply to buses and incorporate trams.

Investment to Date

- 2.26 A large infrastructure project such as the Tram Project requires a substantial amount of work to be undertaken in advance of the main construction works.
- 2.27 The budget for tram infrastructure represents 46% of the overall project budget with the most significant construction elements within this expenditure to date relating to Gogar Depot, the structures along the off-street section of the railway corridor and tram works along Princes Street. Currently, progress against this element of the project is assessed as 24%.

- 2.28 Significant progress has been made on the construction of the 27 tram vehicles. This element of the project represents 11% of the original project budget. Of the 27 tram vehicles, 16 are now complete, with the remaining 11 tram vehicles currently in production. Therefore this element of the project is over 60% complete.
- 2.29 The diversion of utilities has also resulted in a significant enhancement of the utility assets in the City including faster broadband services and enhanced water supplies. In the longer term, these investments made will mean that not only is there a uniquely documented record of all the utility pipes and cables positioning, but already there is a dramatic reduction in bursts of old pipes along the route. Although it is recognised that these improvements have caused disruption, it will mean that in the future, access to utility cabling will be predictable, much shorter in duration and less intrusive to the people of Edinburgh. This element of the project is currently assessed as over 95% complete.
- 2.30 As previously reported, the scope for the utilities diversions has risen from 27,000 linear metres to around 48,000 linear metres. This represents an increase of some 78%. There has also been a consequential increase in cost of around 30% in relation to this scope increase. In total expenditure on utilities is expected to be approximately 10% of the total project cost.
- 2.31 A further area of expenditure relates to the costs of the design and purchase of the land that is required for the project. This accounts for 12% of the project budget expenditure to date; this element of the project is now substantially complete.
- 2.32 The remaining 21% of the project budget relates to project management and other project related items.
- 2.33 In summary, while there has clearly been significant delay to the infrastructure works, a vast amount of work and investment has gone into the tram project to date. Total spend on the project to date is £381m.
- 2.34 As can be seen from this, recent reports of 22% progress for 80% of the funding are both erroneous and misleading.

Funding and Affordability

- 2.35 Given the increasing project costs, it is critical to assess the current committed funding and affordability constraints of the project.
- 2.36 As set out in the Council report of 24th June 2010, contingency planning has been undertaken up to a level of 10% above the current funding, allowing for total funding of £600m. Consideration has also been given to incremental delivery options.
- 2.37 The Council has made an allowance of £2m per annum within its long-term Financial Plan to cover additional infrastructure development costs. This provision would allow the Council to borrow £24m under the Prudential Framework. Headroom within the existing budget for loan charges may also allow future investment in infrastructure beyond this sum if required.

- 2.38 Further borrowing, should it be necessary, can potentially be financed from the future profits of TEL.
- 2.39 Of the current funding, the Council has committed £45m to the project, of which £25m is anticipated from developers' contributions. The slow down in development has impacted on the pace of developers' contributions expected to be received by the Council. However, over the 20 year period set out in the Tram Developers contribution guideline, it still remains possible to achieve the £25m total.
- 2.40 The current predicted negative impact on developers' contributions from incremental delivery is £7m if the route were to be curtailed at St Andrew Square. This means that if the full route of Phase 1a is not delivered then the Council would have to fund this additional £7m as part of their £45m commitment.
- 2.41 Whilst the commitment remains to deliver the full scope of Phase 1a, affordability remains the primary consideration given the current level of funding and the likely forthcoming constraints on public sector spending.
- 2.42 The tram project has faced many challenges since the start of construction. This has resulted in increased costs and significant delay. This has required options to be considered for delivering Phase 1a incrementally.
- 2.43 While a tram operating from the Airport to St Andrew Square can deliver significant benefits, and importantly can be profitable, further benefits would accrue from the full scope of Phase 1a. Therefore, an important assessment will be required at the appropriate time to appraise the benefits to be gained from constructing the full route of Phase 1a versus the capital cost and available funding.

Current Position

- 2.44 In the report to Council on 24 June, Council was provided with an updated position on the dispute between **tie** and the BSC consortium.
- 2.45 Over the intervening months **tie** have been pursuing a twin track approach to try to break the impasse that exists with BSC.
- 2.46 The twin track approach adopted has been;
- To seek to agree a revised scope, price and programme, with the outcome of a tram operating to at least St Andrew Square, with a very high degree of cost and programme certainty.
 - To continue to administer the project in a robust manner; including compiling evidence of any breaches of contract by BSC; clarifying contractual principles regarding contractual changes; and completing the design.
- 2.47 It is important to acknowledge that there has been progress on-site whilst **tie** has been pursuing this twin track approach. Work on-site has been progressing in the West of the city, albeit at a slower rate than would be expected. This

progress off-street is considerable and includes bridges, viaducts and the well progressed construction of the depot.

- 2.48 There have also, however, been some recent developments in relation to BSC apparently demobilising a certain element of their workforce claiming that they will not continue to work on certain parts of the project claiming that they have not been paid by **tie**. **tie** are adamant that all payments properly due have been made to the consortium.
- 2.49 Despite intensive and detailed negotiations having taken place over the last few months, **tie** and the consortium have to date been unable to reach agreement which would achieve a revised scope, price and programme acceptable to both parties. Whilst negotiations have not been suspended, an acceptable commercial settlement now unfortunately appears unlikely in the short term.
- 2.50 **tie** has been exercising its various rights and remedies under the contract. Further to the figures reported to the Council in June, to date the application of the dispute resolution process to disputed matters has reduced BSC's claims for additional payment from £21.9m to £9.5m (a saving of £12.4m). **tie** remains satisfied that the overall balance of dispute resolution including adjudication outcomes has more than justified its interrogation of the initial claims made by BSC. The overall outcome of the DRPs, in terms of legal principles, remains finely balanced and subject to debate between the parties.
- 2.51 Given that acceptable commercial settlement now appears unlikely, all other options for contractual resolution together with alternatives for delivery of the project are being considered by **tie**. However, for commercial and legal reasons, including contract conditions regarding confidentiality, it is important at this point in time that all matters relating to possible contractual resolution remain confidential in order to protect the best interests of both the Council project and the public purse.
- 2.52 One possible option is termination of the current contract where the contractual terms allow this. **Any such decision would clearly have significant consequences and therefore this option will only be considered after taking into account the extensive legal advice which has been, and continues to be, taken in relation to such matters. It is extremely important that the necessary due diligence is undertaken and that there is no precipitate action that could have significant consequences for tie and the Council.** As is to be expected, the contract contains defined mechanisms for dealing with alleged breaches and their potential outcomes, and such processes are already being utilised as part of **tie's** continuous rigorous application of the contractual terms.
- 2.53 In terms of the existing governance arrangements, any recommendation from **tie** and TEL to terminate the contract will require to be presented as a formal request for approval from the Council. Transport Scotland will also need to be informed of the position.
- 2.54 In the event approval for the termination of the contract is sought, **tie** will also bring forward options for delivering the project in an alternative manner. It is proposed that the above matters would form part of a further comprehensive report to be brought to the December Council meeting (or if possible an earlier

Special Meeting of the Council) outlining the recommended available options. This would consider all implications and proposals for the project going forward.

- 2.55 In the meantime, discussions will continue with the consortium to attempt to reach an agreed solution as outlined above.

Governance of Bus and Tram Integration

- 2.56 It has long been a policy aim of the City of Edinburgh Council to develop an integrated public transport network delivering high quality bus and tram services in the city. Over the last two years the Chief Executive has submitted a number of reports to Council on the steps necessary to bring this about.
- 2.57 Work on the final phase of the agreed integration of **tie**, TEL and Lothian Buses has been underway for some time. A number of complex and inter-related actions need to be taken to prepare the way for the revised governance arrangements that the advent of trams will require. As previously reported, a work programme embracing the following key issues is proceeding:
- legal and contractual matters;
 - finance (including tax planning);
 - employment; and
 - communications and reporting.

It is anticipated that these work streams will be completed by the middle of 2011.

- 2.58 To direct and oversee the work programme on bus and tram integration it is essential that senior management arrangements, with clearly specified roles and responsibilities, are in place. As agreed by Council in December 2009 (and having completed all the appropriate HR procedures, based on those used by the Council and involving a "matching process"), the Board of TEL has agreed that Richard Jeffrey will take on the role of Chief Executive (Designate) and Ian Craig will take on the role of Chief Operating Officer (Designate). There will be no change meantime to existing remuneration arrangements or any additional contractual liabilities.
- 2.59 These appointments are an essential foundation for the new arrangements. It gives Richard Jeffrey and Ian Craig the full authority, under the direction of the Boards of TEL and Lothian Buses, to lead the demanding work programme associated with public transport integration over the next nine months and beyond. It will be an early priority for the two senior postholders to establish a shared vision, values and brand for the future; establish a common IT platform; devise and implement management and organisational structures; carry out business planning and drive efficiencies; and carry out training and the like.

3 Financial Implications

- 3.1 As previously reported, the contingency planning work that has been undertaken by the Council and **tie** has identified funding options which could address project costs of up to £600m. Due to the current uncertainty of contractual negotiations, it is not possible to provide an update at this time on the ultimate capital cost of the project.

4 Environmental Impact


- 4.1 The Edinburgh Tram Project will make a positive contribution towards the vehicular emissions and air quality in the city centre and the transport corridor to the West of the city and the airport. This will have a positive impact on current pollution levels and provide a quieter mode of public transport. The tram also provides mitigation against future traffic congestion from population growth and increased commuter demand.


5 Conclusions

- 5.1 Following the recent refresh, the Business Case remains positive, even with incremental delivery only to St Andrew Square.
- 5.2 Whilst negotiations have not been formally suspended, an acceptable commercial settlement now appears unlikely to be achieved in the short term.
- 5.3 Contract enforcement continues with the due legal process needing to be followed prior to a report back to Council.

6 Recommendations

- 6.1 The Council;
- a) Note the position regarding the Business Case and discharge the motion of 24th June 2010.
 - b) Note the disappointing lack of progress in relation to the negotiations and progress of physical works.
 - c) Endorse rigorous application of the contract by **tie**.
 - d) Note that in the absence of robust remediation plans from the consortium and a change of behaviour in relation to progressing the works, serious consideration will need to be given to termination of the contract and re-procurement.
 - e) Note the recent governance developments and future work streams.
 - f) Note that a report will be prepared for the December Council (or possibly an earlier special meeting) on the next steps.


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Appendices None

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Wards affected

Single Outcome
Agreement

Background
Papers