

**REPORT TO:** Mersey Gateway Executive Board

**DATE:** 22 September 2011

**REPORTING OFFICER:** Chief Executive

**SUBJECT:** Mersey Gateway – Progress  
Towards Obtaining Conditional  
Funding Approval from Government.  
**(Redacted for Publication)**

**WARDS:** All

## **1.0 PURPOSE OF THE REPORT**

1.1 Since the project received government support in the Comprehensive Spending Review, announced in October 2010, the Mersey Gateway project team has been preparing an Outline Business Case for the project which meets the requirements of the Department for Transport. This report provides a summary of the final draft OBC which is expected to be cleared by the Secretary of State for Transport, subject to the approval of HMT officials who are reviewing the final draft OBC report during September. Members will recall from previous reports that the formal approval of the OBC together with the government's confirmation of a detailed funding agreement will lead to the project receiving Conditional Funding Approval, allowing the Council to commencement the procurement process. The recommendations in this report deal with key decisions that will advise government that the draft proposals in the OBC and the draft funding conditions are acceptable to the Council.

## **2.0 RECOMMENDATION: That the Mersey Gateway Executive Board**

- (1) Note and agree the proposed draft funding support with conditions as proposed by the Department for Transport; and**
- (2) Note and agree the proposals in the OBC**

The project resources and budget estimated to be required to reach the start of construction is reported separately.

## **3.0 SUPPORTING INFORMATION**

3.1 The draft OBC is attached at annex 1 (commercial in confidence and hence not published in the report to Council of 19<sup>th</sup> October).. This is now a long and complex document with several annexes and following information is intended to provide a high level executive summary of this complete draft document.

- 3.2 The format of the OBC follows the standard requirements of the DfT, and comprises the following main sections:-

### ***The Strategic Case***

- 3.3 The Strategic Case demonstrates that the scheme is consistent with, and will contribute to local, regional, and national objectives in transport and other key policy areas. The high priority given to Mersey Gateway across the sub-region reflects that the project has a close fit with regional and local policy objectives. The approval in the Comprehensive Spending review last year acknowledged the benefits that Mersey Gateway would bring to the delivery of the coalition government priorities. At a more forensic level the decision to grant the statutory powers (planning approval etc) last December confirmed that:-

*“the Secretary of State considers that a clear need has been established for a new road crossing of the Mersey in this location in order to relieve congestion on the SJB and to address the adverse transportation, environmental, social and economic consequences of the existing situation. Furthermore, he is satisfied that the Project represents the most appropriate means of meeting that need, taking into account national and local planning, transport and environmental policies and the exhaustive consideration of alternatives undertaken by the Promoter “*

- 3.4 The Strategic Case remains very strong and reaffirms the longstanding acceptance that Mersey Gateway would deliver widespread benefits that are a priority for national government and for the regional and local community.

### ***The Value for Money Case (including traffic forecasts)***

- 3.5 The Value for Money Case has proved to be resilient against the impact of the lower growth assumptions. The economic downturn has prompted the DfT to revise its national and local traffic forecasts reflecting the absence of traffic growth in general terms across the national road network since 2009. These revised traffic forecasts take the form of TEMPRO 6.2 underlying economic growth and development assumptions that were required to be applied for all scheme appraisal cases considered after April 2011. The traffic forecasts in the draft OBC are based on TEMPRO 6.2 parameters.
- 3.6 The work required by DfT officials has been extensive and has put pressure on resources and project budgets. Although the additional analysis has revealed a relationship between the level of toll charges and the value for money forecast, the base case, where toll levels are similar to those applying at Mersey Tunnels, delivers robust economic benefits that are over twice the net project costs, placing the project in the DfT ‘High’ value for money category.

3.7 The Board should note the impact of the revised traffic appraisal guidance on all of the crossings of the Mersey between the Mersey Tunnels to the M6 motorway at Thelwall, including the combined flow on SJB and MG, as shown in the table below. The figures in brackets are for the earlier forecasts.

**Summary of Average Weekday traffic (1000s)**

<b>2015</b>	<b>All Crossings</b>	<b>Combined Flow SJB+MG</b>
Without Project	410 (455)	85 (94)
With Project	393 (443)	60 (74)
<b>2030</b>		
Without Project	476 (483)	98 (97)
With Project	470 (488)	86 (95)

3.8 Prior to 2008, average weekday traffic flows on the SJB were typically 84-85000 per day. Since 2008 there has been a decline, most noticeable in 2009, to a figure closer to 80000 per day currently – a reduction of about 5%. Most of this reduction has occurred in off-peak periods with peak flows experiencing reductions of 2-3%. The last few years have provided evidence of the relationship between economic downturn and traffic using SJB. Although growth has halted and traffic flows are slightly reduced the demand for the SJB crossing remains high and, given the difference between peak and inter-peak changes over the recent economically difficult times, suggests that business and commuting trips are more resilient to changes in travel cost than the model forecasts might suggest.

3.9 The revised forecasts still show SJB being relieved of over 80% of its traffic. The revised forecasts are now assumed throughout the draft OBC including the toll revenue predictions used in the funding considerations (see Financial Case below).

***The Delivery Case***

3.10 The Delivery Case explains how the Council intends to deliver the scheme to time and within budget and includes the project programme, the governance arrangements, the plans for stakeholder involvement and robust risk management plans. The new work takes into account the changes now proposed in the procurement strategy (see Commercial Case) and how this will impact on the Council organisation required to oversee the construction and operating phase of the project. Again, the progress made in agreeing the revised procurement approach with DfT officials allows the Delivery Case to be updated and submitted in the final draft OBC.

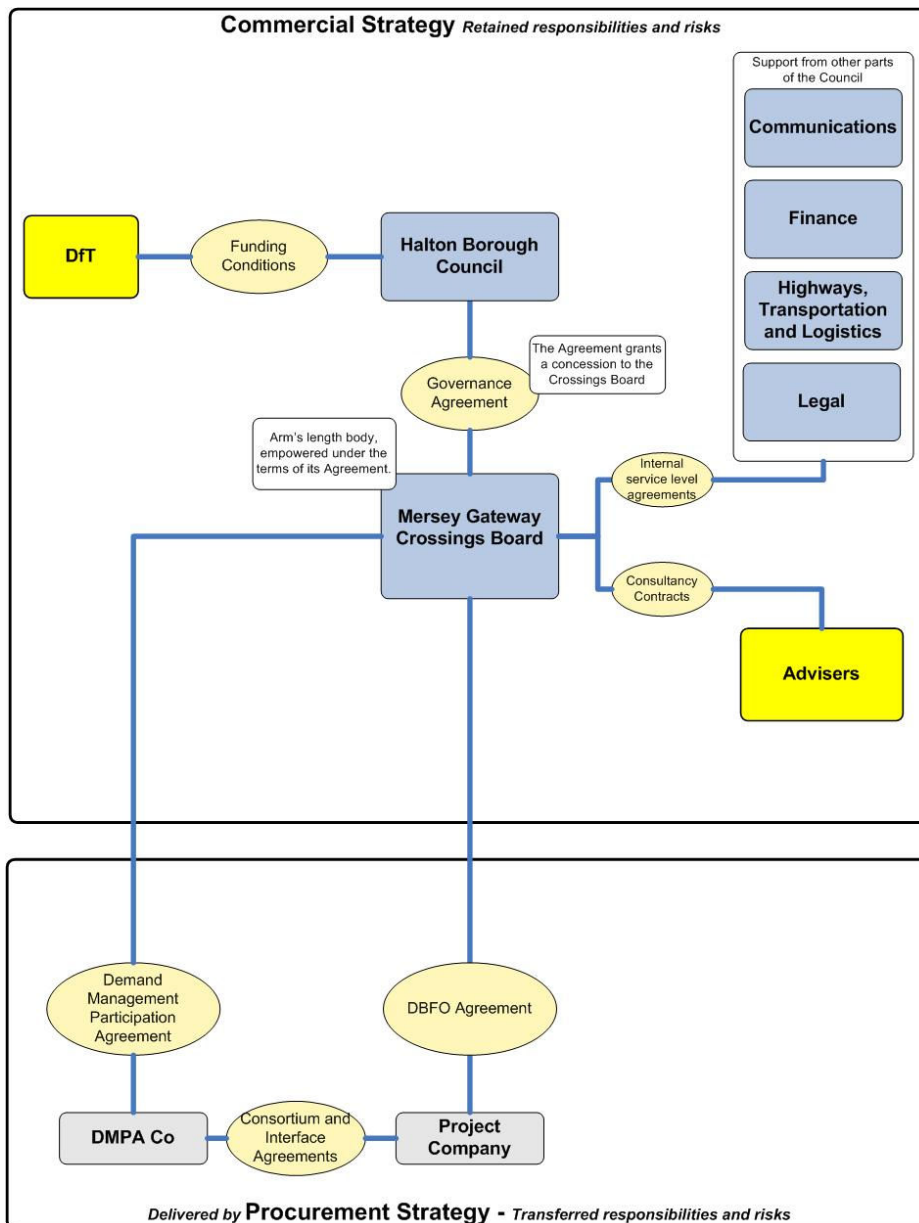
- 3.11 The delivery of this complex project through procurement requires careful and robust preparation ensuring that sufficient resources are available to bring about a satisfactory outcome. The unusual expertise and competence required in the project team can only be delivered through consultancy commissions and these commissions are in place. But these support services will require expert direction and the 'core team' should be providing this direction. A review of resources in the core team revealed heavy reliance on the Project Director during the competitive dialogue process. The proposed solution is to appoint a Commercial Director to support the Project Director by leading the commercial and contract negotiations and directing the financial and legal advisers. In due course the terms of the Commercial Director appointment will be presented to the Executive Sub Committee for approval but a candidate is currently working on an interim basis pending the formal arrangements being agreed. It is likely that officers will recommend that the Commercial Director takes some risk in the project delivery and that any agreement should cover the post procurement phase to assist the Council in managing the transition when most of the project team will depart as the project moves into construction. This succession planning is a necessary part of the OBC and the role of the Commercial Director is explained in this regard.
- 3.12 The project programme is based on Conditional Approval being announced in mid October releasing the Council to publish the Contract Notice in the OJEU at the end of October. The procurement process is planned to be completed in time for construction to commence at the end of 2013.

### ***The Commercial Case***

- 3.13 The Commercial Case now includes a sound procurement strategy and a rigorous approach to the private sector involvement. As already reported to Members the procurement strategy has been reviewed to assess the validity of assumptions relating to market conditions that have been affected by the financial crisis since 2008/9. The aim of the current work is to ensure that the project finance arrangement benefit from the full value of the tolling revenue expected to be received. The project team has reached a consensus view with procurement and finance experts at the DfT that transferring the risk of uncertain toll revenue to the private sector would not deliver best value in the current project finance market. An alternative procurement structure has been developed in consultation with the DfT that is designed to deliver the new crossing at best value, in whole life terms, along with robust arrangements for delivering a modern toll service alongside managing toll revenue risk in the public sector.
- 3.14 Consequently the revised structure means that more risk would be retained by the Council than would be the case in the original proposal where substantive cost and revenue risk would have been taken by the private sector partner – referred to previously as the Concessionaire. In return for taking toll revenue risk the Council can keep toll levels down by

avoiding a higher cost of finance that would apply if the private sector took this risk and the Council, in consultation with our partners, has more control over the setting of toll levels to support the delivery the wider project objectives. To ensure that the management of toll revenue risk is successful, the Council would need to be supported by a robust organisation with appropriate empowerment and responsibilities

- 3.15 The project team however still sees considerable opportunity in working with the private sector partner to ensure Mersey Gateway delivers a modern toll service which is designed to mitigate toll revenue risks, where operation can be alive to future development thereby driving continuous efficiency and best value. There is evidence that toll operations in the public sector become static arrangements often deprived of development potential. Most of the toll roads across Europe and the developed world are run by the private sector often under public sector client control. The revised contract structure is designed to harness private sector expertise across the integration of a Design Build Finance and Operate contract for the new crossing and toll operations for the new bridge and for SJB. The potential bidding groups interested in the Mersey Gateway contract all contain the competence and experience we would require to deliver this integrated service.
- 3.16 The demands placed in the Council in managing the construction and operation of Mersey Gateway will be considerable, again requiring expertise that the Council does not have in the current organisation. The DfT has recognised this in its scrutiny of the emerging OBC proposals. To address these concerns the project team has proposed that the Council responsibilities and risks are managed by a separate entity called the Mersey Gateway Crossing Board, operating under a Governance Agreement with the Council. To convince the DfT that the MGCB would be empowered with the authority required to run a successful toll crossing business the OBC includes draft Heads of Terms for establishing the MGCB. Consequently the arrangements for establishing the MGCB are well advanced and the DfT now see this proposal as being a condition of its funding support (see draft funding conditions below).
- 3.17 The contract structure including the MGCB and the public private partnership arrangements are shown in the diagram below;-



### 3.18 Key commercial responsibilities of the Crossing Board will include:

- Management of cash flow between toll income and the unitary charge payments to the Project Company and DMPA payments;
- Setting tolls within agreed limits (see Funding Conditions below)
- Setting toll strategy and policy and responding to commercial conditions. This is likely to incorporate responsibility for defining the cash flow available to support discounts and the administration and monitoring thereof;
- Monitoring the performance of the Project Company and administration/reconciliation of payments to the payment mechanism

- Support from the private sector via the Demand Management Participation Agreement (DMPA Co in the above diagram).

### ***The Financial Case***

- 3.19 The Financial Case has demonstrated that the scheme is based on sound costings and revenue forecasts and has determined the funding requirements that together forms the Council Conditional Funding Approval bid. Since the completion of the Inquiry all the project costs have been reviewed and new estimates produced. The revised cost estimates take on board all the commitments given to third party interests leading up to the Inquiry which have either changed the project scope or increased cost for other reasons. The project funding arrangements cover whole life costs over a thirty year period and require a view to be taken on the likely maintenance and operating costs over this period alongside the average inflation rates expected.
- 3.20 The funding discussions with the DfT included a requirement for the Council to investigate where cost could be reduced. The DfT had challenged all local transport projects in the priority pool to reduce costs and Ministers expect this to deliver results. This was a difficult task for Mersey Gateway because the scheme had been defined in the planning approvals and made Orders, limiting the scope available to reduce costs without repeating the planning process. Also the programme had slipped around 18months resulting in potentially higher inflation allowance.
- 3.21 The project team has however identified where cost savings are deliverable and the scheme presented for Conditional Funding Approval includes the following cost saving measures;-
1. removal of provision of LRT from Main Crossing (the long term plan would be to use SJB for public transport including potential light rail services)
  2. reinstatement of Halton Lea Slip Roads on Central Expressway
  3. adopting Open Road Tolling
  4. changes to standards on the Main Crossing and Approaches
  5. value Engineering at Lodge Lane Junction (retaining the Busway Bridge)
- 3.31 In outturn terms these measures reduce the estimated construction cost by approximately £33m but and this has prevented the cost increase that would have arisen due to inflation and the impact of undertakings given at the Inquiry. A summary of the changes in estimated cost for the construction and land costs only, compared with the cost estimates produced for the Inquiry (reported to MGEB on 21 July 2008), are shown in Table 1 below.

<b>Construction Costs</b>	<b>£m</b>	
	<b>Pre-Inquiry Estimate 2008</b>	<b>Conditional Fund Bid 2011</b>
Construction capital cost (January 2007 prices)	431	399
Estimated inflation to outturn prices	87	110.
Land and Advanced Works	86	86.
<b>TOTAL PROJECT COST UP TO ROAD OPENING</b>	<b>604</b>	<b>595</b>

Table 1: Projection of Project Cost in Outturn Terms (exc VAT)

3.32 The above measures to reduce project cost are important but the overall funding requirement is also influenced by the estimated operating and maintenance costs over the thirty year contract term and the cost of financing the project. The project team has reviewed the financial model that includes all these costs and has managed to reduce the overall funding requirement by approximately 8 percent. This result was presented by the Chief Executive to the Secretary of State at a meeting on 7<sup>th</sup> July and the cost control has been a major factor in making progress towards securing Conditional Funding approval.

3.33 The Council specification is intended to provide maximum opportunity for the private sector to innovate. A design guide is close to completion which explains the site constraints alongside the requirements of the Council and other third parties, including regulating authorities. The Council, as the Local Planning Authority, will also be called upon to consider submissions under the Planning Conditions that are in place to control the approved development and were issued as part of the planning approval announced in December. The project team are looking to provide bidders with a clear understanding of how the Council will assess the Planning Condition submissions. To assist this a planning officer has been seconded to the project team but it is important that the development control decision remains independent to the promotion of Mersey Gateway. In addition to the consideration of Planning Condition submissions the amendments to the scheme listed in paragraph 3.21 above require additional Planning Applications. The pre-application consultation process for these further Planning Applications is due to take place at the end of September. Presentations to relevant Area Forums are included in the consultation process.

3.34 The Financial Case includes the draft funding contribution we have agreed with DfT officials in consultation with the Secretary of State. The proposed funding package comprises a capped capital grant (Section 31 Grant) of £86m which will cover the acquisition of land (including compensation and fees) and advanced works and surveys, plus the agreed contribution from the DfT towards the preparation costs (£6.4m); and a revenue grant that is payable of up to £14.55m per year for each of the 26 years of the operating term in the DBFO contract. Members will



note that the revenue grant is higher than the £9m per annum agreed in 2006 at Programme Entry stage and the higher amount compensates for the reduction in toll revenue now forecast due to the lower traffic levels expected to use the combined bridges. The draft funding proposals are to be subject to conditions and the Council view on the proposed draft conditions is required to support the final consideration of the Conditional Funding approval bid. The draft funding are explained at Appendix 2 (Not included as superseded by the Funding Letter provided to Council)

3.35 The Board should in particular note that these conditions would have the following impact/

- 1) The Council would be responsible for any overspend in the land assemble and advanced works budget should costs exceed £86m (see separate budget report which puts the current estimate including contingency at just below £86m). The DfT are also looking to fund their contribution (£6.4m) to preparation costs (referred to in 3.34) out of the total £86m but we have requested that this is separated from the capped grant.
- 2) The DfT may not proceed with the project if the DBFO contract cost exceed those in the current Financial model. In this event we have requested payment of part of the £86m where the cause of the cost increase is outside the control of the Council but this has not yet been accepted.
- 3) The DfT would reduce the revenue grant should the cost of the DBFO contract be delivered at a lower cost but the savings would be shared 30/70 in favour of the DfT.
- 4) After five years of operation (and repeated every five years), should traffic using the bridge exceed that forecast in the base case, the revenue grant would be reduced to reflect the higher toll revenue share than expected in the base case financial model. We have asked to retain the same 30 percent of the 'surplus' revenue but this has not yet been accepted (see Funding Letter which offers the Council a 15% share).
- 5) The DfT have allowed the Council to use 10 percent of the toll revenue for discount purposes and for funding sustainable transport measures. This would be increase should actual toll revenue exceed the base case forecasts providing we are successful in securing a 30 percent share of this surplus revenue (point 4). Otherwise the amount available for discount schemes etc. would be capped at 10 percent.

3.46 An oral up date on the draft funding conditions will be given at the meeting.

- 3.47 The funding contribution and draft conditions are based on toll charges currently applying at the Mersey Tunnels and the project team has developed a commercial framework that is designed to make this toll revenue go as far as possible towards contributing to the total cost of the project. By ensuring that economic arrangements are also in place to deliver the DBFO contract at minimum cost the Council will have more scope to satisfy these conditions at Financial Close. The draft OBC is design to achieve this aim.
- 3.48 The draft funding offer from the DfT is based on toll revenues we would collect from traffic levels at the new forecasts reported in the table at para. 3.7 above. (ie opening year flow on combined crossings forecast to be 60,000 vehicles in an average working day). To safeguard the project from the unlikely risk that traffic flows are lower than this forecast the project cost could be further reduced by the Council providing a proportion of the project finance through prudential borrowing. By using prudential borrowing the cost of finance would be reduced and the repayment options would be more flexible than would be the case if all the debt was met by private finance. The draft OBC is based on the Council providing £120m of the project finance through prudential borrowing as this makes sense given it reduces cost and the Council has more flexible repayment options.

#### **4.0 POLICY IMPLICATIONS**

- 4.1 The project is a key priority for the Council which will deliver benefits locally and across the wider region.

#### **5.0 OTHER IMPLICATIONS**

- 5.1 All substantive implications are reported above and in the report annex.

#### **6.0 IMPLICATIONS FOR THE COUNCIL'S PRIORITIES**

##### **6.1 Children and Young People in Halton**

Mersey Gateway provides an opportunity to improve accessibility to services, education and employment for all.

##### **6.2 Employment, Learning and Skills in Halton**

See above

##### **6.3 A Healthy Halton**

Mersey Gateway provides an opportunity to improve accessibility to services, education and employment for all, including improved cycling and walking facilities.

##### **6.4 A Safer Halton**

Mersey Gateway is forecast to deliver road safety benefits for vehicles and facilitate safer conditions for walking and cycling in the borough

#### **6.5 Halton's Urban Renewal**

Mersey Gateway is a priority project in the urban renewal programme.

#### **7.0 RISK ANALYSIS**

7.1 The results of the Market Engagement will help to reduce overall project risk and improve value for money and delivery.

#### **8.0 EQUALITY AND DIVERSITY ISSUES**

8.1 Mersey Gateway provides an opportunity to improve accessibility to services, education and employment for all.

#### **9.0 LIST OF BACKGROUND PAPERS UNDER SECTION 100D OF THE LOCAL GOVERNMENT ACT 1972**

9.1 None under the meaning of the Act

**Appendix 1 (Not included in Report to Council of 19<sup>th</sup> October 2011  
as Report is commercially sensitive. Redacted OBC to be published  
at end of October**

**Appendix 2**

**(Not included in the Report to Council 19<sup>th</sup> October as superseded by draft Funding Letter of 13 October 2011 )**