

**REPORT TO:** Mersey Gateway Executive Board

**DATE:** 19 September 2013

**REPORTING OFFICER:** Chief Executive

**PORTFOLIO:** Leader

**SUBJECT:** The Final Business Case and Final Funding Submissions

**WARDS:** All

## **1.0 PURPOSE OF THE REPORT**

- 1.1 Prior to achieving Financial Close (when contracts are awarded to the Preferred Bidder and all project funding is committed in contractual terms), the Council is required to submit the Final Business Case, which includes the Final Funding Submission, leading to confirmation that Ministers (Department for Transport and Treasury Ministers) have approved these submissions. This report explains the key issues to be addressed in these submissions so that members can influence the preparation of the documents at this early stage.
- 1.2 Members should note that commercially sensitive information has been avoided to enable the general position to be reported openly.

## **2.0 RECOMMENDATION: That**

- (1) The Board confirm (with any comments) that they are content with the approach being taken in preparing the Final Business Case and Final Funding Submission.**

## **3.0 SUPPORTING INFORMATION**

- 3.1 The Board will recall that the current funding agreement with Ministers is expressed in the Conditional Funding Approval letter received in October 2011 and agreed by Full Council on 19<sup>th</sup> October 2011. A copy of the Conditional Funding Approval letter is at Annex 1.
- 3.2 The current funding agreement was secured through the approval of the Outline Business Case prepared in 2011. The approval is conditional because the confirmation of funding is subject to several requirements, all of which are in the process of being satisfied and reported in the Final Business Case (FBC).

- 3.3 The FBC will either rest on the information reported in the Outline Business Case, because nothing substantive has changed, or it provides an update of proposals, with more detail, including modified positions where they exist. The following provides an executive summary of the developments to be reported.

#### *Strategic Case*

- 3.4 The Strategic Case covers broadly the extent that Mersey Gateway is consistent with local and government policy. The need for Mersey Gateway is as least as compelling as that already accepted by Ministers and we therefore propose to rest on the strategic case already made. We will however record that the project is now a top 40 priority in the National Infrastructure Plan.

#### *Scheme Description*

- 3.4 The highway scheme is now based on the Preferred Bidder design but the scope is consistent with the scheme reported in the OBC. The Board should note that the works required to delink the approach roads to Silver Jubilee Bridge on the Widnes side including the alterations to the Silver Jubilee Carriageway are included but any works to the south in Runcorn are excluded (this reflects the position in our Conditional Funding bid).
- 3.5 The scheme will transfer the existing Central Expressway route down to M56 Junction 12 to the Project Company who will become responsible for the improvement and all maintenance of this route for 30 years after Financial Close.
- 3.6 The main development to report will be the tolling proposals drawing on the Preferred Bidder's Tolling Service Business Plan and the more detailed proposals for a Local Toll Discount Scheme. The latter is still under assessment and consideration but the Council will need to select its preferred scheme for offering local discounts prior to concluding the FBC submission. The key message will be that the project has been delivered with toll charges similar to those applying at Mersey Tunnels and there is an opportunity to offer a local discount scheme because the project is expected to be delivered under budget.

#### *The Value for Money Case*

- 3.6 This Value for Money case deals with the benefit to cost ratio and other more qualitative factors that take into account the wider economic benefits (regeneration and job creation etc.) that we expect the project to deliver. Although we plan to undertake some minor updates (for example, to reflect that the project is expected to be delivered within budget) the value for money case will remain as that approved in the Outline Business Case.

### *The Delivery Case*

- 3.7 The Delivery Case will include the more detailed and specific construction programme proposed by the Preferred Bidder where work commences early next year with the new crossing opening in summer 2017. Much of the project management activity will transfer to the Preferred Bidder and the interests retained by the Council will be delegated to the Mersey Gateway Crossing Board. We will require a final draft of the Governance Agreement between the Council and the Crossings Board to support the FBC (progress reported separately).
- 3.8 At Financial Close we are required to give the Project Company access to all the scheme land which means we need to complete the land assembly programme. Very few plots are still to be acquired and we do not envisage any problems in completing the outstanding acquisitions. Although the Council remains the registered owner of the scheme land most of the responsibilities of ownership will be transferred to the Project Company at Financial Close (one exception being the responsibility for existing contamination on the scheme land).
- 3.9 To test the robustness of our delivery case we are required to undertake the next formal Gateway Review (No3). This is planned to take place in late October to inform the final consideration of our FBC.

### *Commercial Case*

- 3.10 The Commercial Case (together with the Financial Case that follows) reflects the main changes since OBC.
- 3.11 In summary the Commercial Case reports the risks we have transferred to the Project Company as drafted in the Design Build Finance and Operate Contract and the Demand Management Participation Agreement. Although we have delivered the commercial case within the boundaries expected we can report a very successful outcome in limiting the Council responsibility during construction and the commencement of operations. For example the Council will be exposed to limited cost and programme overrun during construction up to the point where tolling services and the collection of toll revenue are proven (when Full Operating Commencement Certificate will be awarded to the Project Company and the service payments, called the unitary charge, will commence). During the period up to FOCC the Project Company will be responsible for delivering the new crossing and in meeting specific tests to ensure they can collect toll revenue to the contract specification before the Council (ie the Board) is required to commence payment. This means the Council will not be exposed to commencing the payments for the new crossing before it has the toll revenue to meet these payments.
- 3.12 During construction the Project Company has accepted most of the responsibility for dealing with a contaminated site. To improve value

the Council will share the cost risks where contamination is exceptional and where the requirements depart from what has been agreed with the regulators. The liability is capped at circa £8m and the Financial Submission (see below) allows for this.

- 3.12 After achieving FOCC the Project Company transfers the responsibility to collect tolls to the DMPA Company. From this point the DMPA Co has a responsibility to pass to the Crossing Board (via a Council Bank Account) 100% of the theoretical toll revenue based on the traffic using the new crossing (at this point SJB is planned to be closed for maintenance works). To manage this risk the DMPA Company is entitled to retain penalty charges provided these do not exceed more than 10% of theoretical revenue. This is an important risk transfer given the novelty of operating an open road tolling system in the UK. The Board should note however that once responsibility for toll collection passes to the DMPA Company the incentive for performance is limited to a performance bond of £20m. Should the DMPA Co fail to meet its obligations to pay 100% theoretical revenue and the gap exceeds £20m then the DMPA contract is likely to be terminated and the responsibility passed to the Council.
- 3.13 The successful procurement process will also be reported highlighting any lessons we have learned.

#### *Financial Case*

- 3.14 This section provides a summary of the Financial Case and explains what will be taken forward to the Final Funding Submission.
- 3.15 It may assist the Board by listing the various cost heads that are required to be funded and provide a status report for each

#### 1. Land Assembly Costs;

Since the Council agreed the initial funding with Ministers back in 2006 we have managed to deliver the land assembly within the £86m capital grant. We are intending to report in the Final Funding Submission that the £86m will be sufficient to deliver the land assembly including any outstanding compensation claims. Members should note however that this is based on an estimate where compensation claims have yet to be agreed and a contingency will be held back to reflect the risk should costs outturn at higher figures than those in the estimate. The risk that cost outturn to produce a total requirement exceeding £86m is small but the Board should note that should this unlikely event occur the Council would be responsible for meeting any costs above £86m.

#### 2. Development Cost Budget;

The Council has been responsible for funding the development cost budget through a combination of prudential borrowing (part of the

Capital Programme) and investing Council reserves. From 1 October 2013 the funds required to complete procurement will be transferred to the Crossing Board Financial Model (see 3). To assist the Council the Department for Transport has agreed to contribute towards Development Costs providing there is scope to fund such a contribution through the headroom in the £86m grant reported in 1 above. The outturn Development Cost up to 1<sup>st</sup> October 2013 is estimated at £41.4m of which £12.4m] has been secured through DfT contributions and £3.5m from the former NWDA. At Financial Close the Council will receive a reimbursement of £10m towards its reserves so the net investment made by the Council in delivering the project to the completion of procurement would be £15.5m.

### 3. Crossing Board Costs;

A Financial Model has been produced to cover all the costs falling to the Crossing Board from 1 October 2013 when the CB is to be established, initially in shadow running status. The model covers a thirty year period but the Financial Case will recommend that Board costs are reviewed every five years as part of the Board Business Plan to be agreed with the Council.

The Funding for Crossing Board costs is provided by the combination of the base case toll revenue and the annual availability support grant provided by the Department. The cost overrun risk will be managed through the Board financial reserves and surplus toll revenue.

### 4. DBFO Unitary Charge

The Council through the Board will be obliged to pay the Project Company the annual unitary charge in monthly instalments. These are 'capped' at the amount agreed in the Project Agreement for each year but could be reduced should performance fall below that required. The annual unitary charge increases to the profile agreed in the Project Agreement and the increase reflects inflation. The Council is therefore exposed to inflation risk but can manage this risk because tolls charges are also expected to be increased in line with inflation, as the Unitary Charge is funded through a combination of toll revenue and the availability support grant. The Financial Case will assess the inflation risk and demonstrate that this can be mitigated satisfactorily by regulating toll charges.

### 5. DMPA Service Subsidy

The Council through the Board will be obliged to pay the DMPA Co an annual service subsidy for seven years. The service subsidy is capped but again subject to inflation. Again these are funded through the combination of toll revenue and the availability support grant. To produce project funding required for 30 years the DMPA service subsidy is extrapolated to cover year eight to thirty applying the year

eight cost plus a 15% contingency. The Financial Case will recommend that the costs for procuring tolling services beyond year seven is reviewed as part of the periodic funding review proposed in the funding agreement with the Department.

To further incentivise the DMPA Co. it is proposed that they have a 50 per cent share in the first band of toll revenue above the base case up to a maximum of £2m per year.

3.16 The Financial Case will also confirm the revenue required to meet the above costs as follows;

1. Capital Grant:

As explained above the £86m capital grant is sufficient to deliver the land assembly programme even after allowing for the contribution to the development cost budget agreed with the Department.

2. Annual Revenue Grant.

The Preferred Bid requires a reduced annual revenue grant compared with that agreed at Conditional Funding Approval. The Board should note that during procurement the Department agreed to modify the profile of the grant from the flat £14.4m per annum to providing more grant in early years and less grant in later years. This revised profile keeps the total value of the grant the same but the revised profile produced better bids.

The savings in grant will be shared 70/30 with the Department. The Final Funding Submission will confirm the actual shares based on the final prices at Financial Close.

3. Council Capital Payment (loan)

To reduce the cost of finance and to provide more flexibility over the repayment of project debt the Conditional Funding Agreement included the Council paying £120m towards construction cost in the form of a loan that would be repaid out of future toll revenue. The base case revenue allows for the interest to be paid on the prudential loan. To improve value for money it is likely that the size of the loan will be increased to circa £140m to deal with cash flow requirements before toll revenue is available and because the additional interest will be more than offset by the reduced interest paid on the correspondingly lower private sector debt.

4. Toll Revenue.

The Final Funding Submission will assume the same Base Case toll revenue forecasts that were produced for Conditional Funding

Approval. This means the financial model will assume £44.5m toll revenue in the opening year (not allowing for the revenue lost due to the local residents discount scheme).

To ensure financial institutions have the confidence to invest in Mersey Gateway the Department has agreed to support the base case toll revenues. This support will mean that should revenues fall below base case and the measures used to recover the shortage of revenue (such as increasing tolls by up to 20%) prove to be inadequate, then the Department will make up the shortage of toll revenue in the form of additional grant (likely to be a loan that would be repaid when revenues recover above base case).

The condition for sharing surplus revenue with the Department at 85/15, after allowing for all project costs will remain.

## 5. Crossing Board Financial Reserve

The Final Funding Submission will include a reserve fund to assist the Crossing Board to stand the risks it is being asked to take. During construction the reserve will be provided in case the contaminated land risk sharing mechanism is applied. It is likely that during construction the reserve will be under £10m for the four year period.

During operation it is proposed to increase the reserve to circa £20m to cover short term loss of toll revenue before the use of the crossing settles down to a more steady state of demand. After five years of operation the need for the reserve will be reviewed and it could be reduced or removed.

## **4.0 POLICY IMPLICATIONS**

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

## **5.0 OTHER / FINANCIAL IMPLICATIONS**

- 5.1 All substantive implications are reported above

## **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**

Over 500 construction jobs will be required for MG and matters are in hand designed to ensure the local community has access to these job opportunities. In the longer term, several thousand jobs are forecast to be created in the sub-region due to the wider economic impact of the project.

### **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**

The project will produce road safety benefits for road users including improved cycling and walking facilities.

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

Mersey Gateway Project is a priority project in the Urban Renewal Programme.

## **7.0 RISK ANALYSIS**

The substantive risks are explained in the above background section.

## **8.0 EQUALITY AND DIVERSITY ISSUES**

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

## **9.0 REASON FOR DECISION**

This report is for information only

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

None under the meaning of the Act.