NET benefits

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NET phase two forms part of the UK governments national infrastructure plan, and is a £570 million ($900 million) scheme to extend the citys tram network. The completion of the negotiation of the private finance initiative (PFI) concession agreement on 15 December 2011 resulted in the appointment of Tramlink Nottingham to take over the operation and maintenance of the existing NET line one from the incumbent concessionaire, as well as taking on responsibility for the design, construction, commissioning, operation and maintenance of two new tram lines for a period of 22 years.

NET phase two will double the length of the tram system to more than 30km, increasing the tram fleet and expanding tram infrastructure across the Nottingham conurbation. The lines are scheduled to open to passengers at the end of 2014 and are initially expected to generate an additional 10 million passenger journeys per year on the extended NET system. NET phase two will serve key areas of population such as Chilwell, Beeston, Clifton, the Meadows ,and key locations such as the ng2 development site, the Queens Medical Centre (the main regional hospital), the University of Nottingham, with both NET phase two lines terminating at new park and ride sites near junctions 24 and 25 of the M1 motorway. The combined network will provide a peak service of 8 trams per hour in each direction between Nottingham Station and Hucknall, Chilwell and Clifton, respectively.

Tramlink Nottingham has sub-contracted the construction of NET phase two to a Vinci (Taylor Woodrow) and Alstom joint venture, with operations and maintenance of the entire network passing to a joint venture of Keolis and Wellglade (a local bus operator). Alstom will also provide continuing tram maintenance services. Each of these contractors will contribute 12.5% of the equity investment in Tramlink Nottingham, alongside Meridiam and OFI Infravia, which will contribute 30% and 20%, respectively.

NET phase two will:

* Serve 20 of the citys 30 largest employers and provide access to over 1,270 workplaces in the city, which account for approximately 55,000 commuting employees.

* Generate employment during the life of the construction project and, directly and indirectly, up to 8,000 long-term jobs, boosting the local economy by around £390 million per year.

* Position the Nottingham tram service as a viable commuter channel. This includes stops within 800m of the University of Nottingham and the Queens Medical Centre.

* Establish Nottinghams railway station as the citys main transport interchange. The station itself is receiving a £64 million redevelopment, which will provide Nottingham commuters with an easy to navigate interchange between trams, trains, taxis, cars, cycling and walking.

The long journey to close

Almost immediately upon financial close of NET line one in May 2000, the citys council started the process of scheme development, public consultation, government approvals and competitive procurement that would precede completion

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of NET phase two. The council and its adviser needed flexibility and innovation to overcome the challenges that arose during this process.

After a considerable period of public consultation and design development, the project was awarded programme entry approval the first stage in the UK Department for Transports (DfT) approval process in October 2006, with funding support of up to £437 million in PFI credits. This was no mean feat, given that both Leeds Supertram and Merseytram had been cancelled in November 2005, casting something of a shadow over the UK light rail market. The funding contribution from DfT represented 75% of the projects cost estimate, with the remaining 25% to be met locally by the council. The council met this requirement by developing the workplace parking levy (WPL) a charge on employers that provide workplace parking in the Nottingham City administrative area. WPL, a demand management tool focussing on commuter parking (and a somewhat silent partner in the successful delivery of NET phase two), was in itself a challenging project to develop, and was subject to a parallel development and approval process to NET phase two.

After a series of public inquiries into the proposals in late 2007 and late 2008, and upon securing the required legal powers to proceed with the project, the DfT granted conditional approval in July 2009, with funding support of £530 million in PFI credits. This increase in funding, maintaining the 75:25 ration between central and local funding, reflected the submission of the business case during the depths of the last bank liquidity crisis and the impact it had on funding terms.

The city council also had to deal with the withdrawal of Nottinghamshire County Council as a co-promoter in June 2009, after a change in local administration. The city council and its team reassured central government that there was a strong case to continue, and conditional approval paved the way for the formal tendering process to commence. An OJEU was issued in September 2009 and attracted responses from two consortiums; Arrow Connect and Tramlink Nottingham. NET phase two was procured using a negotiated procedure, which allowed the council the flexibility to discuss and negotiate solutions with candidates.

In October 2010, the autumn government spending review contrived to coincide with the final tendering process, since submissions arrived in December 2010. The project was subjected to a near 20% reduction in central government support, with the subsequent funding gap being filled with, amongst other things, cost reductions in the procurement process, an authority capital contribution of £100 million, as well as the council and its advisers rapidly mobilising the European Investment Bank (EIB) to support the project and provide access to a cheaper source of financing.

Lastly, in the weeks running up to financial close, the sovereign debt crisis in Europe threatened to derail the project at the final hurdle, as the banking group required the addition of a fourth commercial lender, as well as an increase in margins, to secure final credit approvals. The council, Tramlink Nottingham and all the advisers had to work extremely closely in these final months to ensure the project stayed on track.

A local transport PFI benchmark

NET phase two was the UKs largest local authority transport deal to close in 2011, and the councils group of advisers, which included project and commercial management support from Turner and Townsend, set out to replicate the delivery of NET line one. The first phase project was used as a template for the structuring and delivery of phase two, which took on board the lessons learned in the first process. Supplementing these lessons were three market-sounding exercises, which provided extra insight into what would contribute to the success of the project. For instance, following phase one, the council let a design development contract to provide a greater level of design understanding, which reduced the delivery risk and resulting cost premium for NET phase two. Retaining a design-build-finance- operate approach, to achieve a clear and full transfer of system integration risk, was of paramount importance.

The procurement and negotiation of a PFI concession that transferred revenue risk to the private sector, as well as risk in the original system, was, in the current market, a significant achievement in itself. The concession also included a revenue sharing mechanism as well as bespoke provisions to allow for the design, construction, financing, operation and maintenance of future extensions without necessarily having to terminate the concession.

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The planning complexities, coupled with the financial, legal and commercial structuring for the termination of the NET line one concession (including negotiating with five shareholders, the incumbent sub-contractors and the funders), and the acquisition of the concessionaire company, which completed on the same day, made the procedure extremely complicated, creating serious challenges for the council and its advisers. We understand that this is the first time that a local authority in the UK has bought the incumbent concessionaire of a contract that is to be terminated.

Termination agreements, releases and consents from the NET line one funders required careful negotiations, in order to enter into NET phase two and to ensure a seamless handover of NET line one operations. The new deal involved terminating all the existing PFI arrangements, transferring all the assets, systems and contractual rights to the council and the new concessionaire, acquiring the existing project company and entering into a new PFI contract on the same day. An escrow arrangement allowed the release of the NET line one termination documents and Arrow acquisition documents to occur sequentially. The result was effectively three closes at two different locations, these transactions all taking place on the same day and involving the near simultaneous breaking of the existing interest rate swaps alongside the execution of a new one for NET phase two.

The funding challenge

Tramlink Nottingham was appointed preferred bidder on the 23-year concession on 29 March 2011 and assembled a project finance package of £590 million. This package combined £310 million of commercial debt which included a £100 million capital contribution bridge with £110 million of EIB debt.

Meridiam and OFI Infravia provided additional mezzanine debt and all the co-sponsors provided equity to the project company, in addition to using existing tram revenues. Four commercial banks were involved in providing senior debt; BBVA, Credit Agricole, Royal Bank of Scotland and Bank of Tokyo-Mitsubishi UFJ, which joined the financing towards the end of the process when the basic loan structure was agreed. Between them, each commercial bank has equally split the £310 million commercial loan.

DfT will provide funding of up to a maximum £371 million towards the total maximum scheme cost of £570 million. The council will provide the remaining funding over the 22-year concession life, largely from revenues from the workplace parking levy. Following advanced works to clear land and divert utilities, construction on both new lines will start simultaneously in March 2012, with the network opening fully to the public in late 2014.

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The NET2 advisory group

DLA Piper ran the three concurrent closes for NET2 at different locations on the same day. Leading the team that advised the council were Natasha Luther-Jones, partner in the firms projects group, and Jonathan Procter, head of corporate in Yorkshire, as well as lawyers from DLA Pipers projects, corporate, real estate, restructuring and litigation teams in Leeds, who have advised Nottingham City Council on a variety of legal and commercial matters over the last 10 years.

The firms work encompassed both legal and commercial advice, advising on the procurement routes, drafting and negotiating contractual solutions, preparing procurement documents, assisting with the business cases and other documents that would have to be submitted to the DfT for approval, structuring and drafting payment provisions involving capital contributions and advising on the powers of the council to undertake the array of activities required for such a complex project.

PwCs Richard Abadie, John Carr and Alastair Howcroft from its infrastructure and government advisory team also

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advised the council. PwC provided financial and commercial advice throughout the schemes development and the subsequent procurement process and has advised the council over the last 10 years.

This work involved constructing a bespoke financial model including funding structure to underpin the various business cases submitted to DfT, preparing value for money and affordability assessments and determining the financial and commercial implications of terminating NET line one, development of the payment and revenue sharing mechanisms, structuring of the capital contributions, preparation of procurement documents and negotiation of financial and commercial aspects of the NET phase two concession.

It also provided intelligence on the state of the banking markets, specific lenders and movements in pricing, and this work was instrumental in attracting the EIB to the project after the spending review. PwC led the NET line one interest rate swap close-out process at financial close, and also provided financial and commercial advice on the development of the workplace parking levy.

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