



Committee report

Committee	CABINET
Date	TUESDAY, 13 OCTOBER 2009 AT 6.00PM
Title	FUTURE OF THE RYDE GATEWAY PROJECT
Report of	The Cabinet Member for Environment and Transport

PURPOSE

1. To determine whether or not to proceed with the Ryde Gateway Project.

CONFIDENTIAL / EXEMPT ITEMS

2. Information contained in appendices A and B of this report is excluded from publication on the grounds that there is likely to be disclosure of exempt information as defined in paragraphs 3 of Part 1 of Schedule 12A of the Local Government Act 1972. The disclosure of commercially sensitive information would prejudice the Council's financial interests and therefore in all the circumstances of the case, the public interest in maintaining the exemption outweighs the public interest in disclosing the information.

BACKGROUND

3. The Ryde Gateway project was initiated by the Council's 2002 Local Transport Plan. The development is centred on a new railway and bus station on the site of the current Ryde Esplanade Station. The existing site and building is owned by Network Rail and the new facility, together with the assembled land, would remain in Network Rail's ownership.
4. Planning Permission and Conservation consent for the Ryde Gateway Project were granted in November 2005. Conditional financial approval was also sought from the Department for Transport (DfT) and a sum of £6,200,000 was agreed in January 2007.
5. A delegated decision entitled "Ryde Interchange – Approval to construct" was taken during July 2007 which authorised the total cost of the project as £7,740,000. This sum was further revised to £8,240,000 in February 2008.
6. At its meeting of 9 September 2008, the Council's Cabinet agreed to allocate an additional £1,500,000 to the Ryde Gateway Project. At the time of this decision, concern was expressed as to the ongoing delays to the project and resultant

increase in costs. The Council was then facing difficult financial decisions and the decision to proceed and allocate additional resources to this project had to be balanced against all Council spending priorities. This increased the total cost of the project to £9,731,381. In addition, the Cabinet authorised the undertaking of a further tendering exercise to ensure compliance with European procedures.

7. Following the decision by Cabinet on 9 September 2008, an Official Journal of the European Union (OJEU) pre-contract notice was issued and expressions of interest received from several potential contractors. However, evaluation of the expressions of interest was put on hold pending resolution of several key issues with Network Rail.
8. During November 2008, work was undertaken on the site to install one test pile, four anchor piles and one permanent pile. The purpose of the early commencement piling works was to verify the ground conditions and establish the degree of difficulty likely to be encountered during piling, e.g. underground obstructions. The data obtained would be used to optimise the design (length and diameter) of the permanent piles and hopefully save cost.

This work was deemed by the Council's Planning Services department to constitute commencement of works thereby avoiding the need to reapply for planning permission for this project.

9. The Council's view is that Network Rail has shown a degree of inflexibility and lack of understanding of the wider aims of this project. They have introduced additional requirements at unacceptably late stages in the project and these difficulties led to the escalation of the outstanding issues to Network Rail's directors in January 2009.
10. The three key outstanding issues highlighted to Network Rail in January 2009 were the terms of the asset protection agreement and in particular the cap on Network Rail's liability, the requirement for a profit sharing agreement and the cost of the temporary works and station fit out requirements. The implications of these arrangements are outlined in paragraphs 14, 15, 16 and 17 below. In addition to this, the Council remained concerned that Network Rail had to that date been unable to quantify the cost of their involvement in the project, effectively creating uncertainty as to the total cost of this project to the Council.
11. Following an exchange of letters and telephone calls it became apparent that responsibility for this project was shared between several of Network Rail's directors. In order to progress this issue the Council continued to press for a meeting with Network Rail's director/s to finally reach agreement on the outstanding issues. Both the Department for Transport (DfT) and the Government Office South East (GOSE) offered their assistance in arranging a meeting. The meeting was finally arranged for and took place on 2 June 2009.
12. Prior to the meeting and in order to try and progress matters the Council and Network Rail continued to negotiate options for a profit sharing arrangement that would be acceptable to both parties.
13. The meeting with Network Rail on 2 June 2009 was attended by their Wessex Route Director. In addition, representatives from South West Trains and the Department

for Transport were present. The following key issues and actions were discussed and agreed:

- (a) The cost to the Council of Network Rail's involvement
Network Rail agreed to provide an estimate of the cost to the Council of Network Rail's involvement in the project through to its completion, as well as a statement of the costs already incurred by Network Rail.
- (b) The cap on Network Rail's liability in relation to the project
Network Rail agreed to extend their liability from £75,000 to £124,000. This essentially means that Network Rail's liability for any disruption, delay or other increase in cost as a result of their actions is limited to £124,000. Network Rail also agreed to provide the Council with a scale of charging for increasing the cap in liability over and above the figure of £124,000.
- (c) Temporary Works / Station Fit Out and Replacement of Life Expired Systems
South West Trains insisted that they had documented evidence of the Council having agreed to pay for the temporary and permanent station fit out requirements as well as to replace existing life expired systems. To date this evidence has not been forthcoming.

14. **Network Rail Cost to Completion and Temporary Works / Station Fit Out and Replacement of Life Expired Systems**

On 3 July 2009, Network Rail provided an estimate of their costs to complete the project. The total estimated cost is £668,000. This represents an increase of £374,000 on previous estimates.

According to Network Rail the increased costs are attributable to:

- Network Rail project management costs
- South West Trains legal and other costs
- Temporary Ticket Office
- Relocation of Equipment
- Permanent Ticket Office

As can be seen from the above, Network Rail has included the temporary works, station fit out and replacement of life expired systems in their additional costs. The Council does not agree that it is liable for all of the above costs, however Network Rail has indicated that the Council will be expected to bear these costs should the project progress.

15. **Network Rail Cap on Liability**

As stated previously, Network Rail has agreed to increase the cap on their liability to £124,000. This is not a large sum when considering that the projected cost of the project is in excess of £9,000,000; however it needs to be considered alongside the risk of Network Rail incurring any liability which is considered to be low.

Network Rail has indicated that to increase their cap on liability they would charge the Council 10% of any additional amount required over and above the £124,000 limit that they have offered. For example, were the Council to request that Network Rail's cap on liability was increased to £224,000, the cost to the Council would be £10,000. This is calculated as follows:

£224,000 - £124,000 = £100,000
£100,000 x 10% = £10,000

16. **Profit Share**

Network Rail is insisting on a profit sharing arrangement whereby the Council would receive a “Tenant’s Protected Income” over and above which 50% of the net profit will be paid to Network Rail. This would provide the Council with a 5.5% return on our investment. The Council has always been of the view that this level of return is unacceptably low given the high risk to the Council associated with Network Rail’s six month rolling break clause.

The six month rolling break clause, which is required by Network Rail to be included in the lease, provides Network Rail with the ability to reclaim the Ryde Gateway Station for “operational” reasons, providing the Council with six months notice to vacate the site. The six month rolling break clause is standard for Network Rail buildings.

The implications of the six month rolling break clause for the Council are:

- (i) Under standard DfT terms and conditions for grant monies, anything which is constructed should stand for ten years or there is the possibility that money will be clawed back.
- (ii) Network Rail is not under any obligation to pay the Council any compensation or to hand the development back to the Council once the cause of the break clause being invoked has been removed.
- (iii) The Council would need to incorporate a similar break clause in leases to sub-tenants of the completed development. This could deter potential tenants from establishing businesses in the new building, thereby impacting on the ongoing commercial operation of the Ryde Gateway once constructed.

In a delegated decision taken in March 2008, the Council formally accepted that the six month rolling break clause would be required as part of the lease agreement with Network Rail.

The Council’s concern with regard to the level of return and associated risk has been confirmed by independent valuation advice. A reasonable commercial return would be expected to be in the region of 10%. Network Rail has recently endeavoured to reduce the risk to the Council by amending other terms, however the 5.5% return to the Council remains unchanged. At this stage the profit share terms as proposed by Network Rail remain unacceptable to the Council. Should there be a decision to proceed with construction of the Ryde Gateway building, it will need to be on the basis of the above mentioned profit share arrangement being agreed with Network Rail as, whilst it is the view of the project team that these terms are unacceptable, Network Rail has confirmed that this is their best and final offer.

Given the ongoing revenue implication set out in paragraph 20 below, it is unlikely that the threshold would be reached in any given year whereby the profit sharing arrangement would come in to force. This reinforces the statement that the return on the Council’s investment will be considerably lower than would be commercially acceptable.

17. **Cost to Complete the Project**

As stated above, at its meeting of 9 September 2008, the Council’s Cabinet agreed the total cost of construction of the Ryde Gateway Project to be £9,731,381. The

additional costs which Network Rail has now notified us of, together with an increase in contract costs as a result of the extended programme for the project, increase the total projected build cost to £10,465,000. Given the difficulties experienced on this project and in particular the delays as a result of Network Rail's actions there is a risk that costs will escalate beyond the figure of £10,465,000.

18. The sum of £10,465,000 is calculated as follows:
- | | |
|--------------------------|---|
| Contract Costs | £6,957,000 (increase of £90,000) |
| Fees 2005 / 2006 | £ 407,000 (unchanged from September 2008) |
| Fees 2006 / 2007 | £ 520,000 (unchanged from September 2008) |
| Network Rail Fees | £ 668,000 (increase of £374,000) |
| Fees and Ancillary Costs | £1,207,000 (increase of £255,000) |
| Project Management | £ 254,000 (unchanged from September 2008) |
| 5% Contingency | £ 452,000 (unchanged from September 2008) |
| Total | £10,465,000 |

This represents an increase of £734,000 on the total cost to build agreed by Cabinet in September 2008. The costs remain indicative and are subject to verification on commencement of contracts with the various organisations in the supply chain.

19. The above costs would be funded as follows:
- | | |
|------------------------------------|------------|
| Department for Transport Grant | £6,200,000 |
| Network Rail Contribution | £ 240,000 |
| Isle of Wight Council Contribution | £4,025,000 |

20. **Ongoing Revenue Implications**

Changes in the current economic climate have resulted in the Council revisiting its assumptions with regards to the twenty five year cash flow projections associated to the Ryde Gateway building once built. The changes are reflected in two key areas:

- a) Rental Income – Changes have been made to reflect the more depressed economic conditions. These include lower rents and more frequent lease break clauses with periods of nil / reduced rent between leases to reflect reduced tenant demand.
- b) Six month roiling break clause – The revenue implications of the Council paying for insurance policies to offset the risk of the six month rolling break clause and the potential investment loss to the Council as well as the Council's sub-tenants has now been included in the cash flow projections.

A further complication with regards to the cash flow projections is that the current design of the building includes a substantial first floor space which it is anticipated will be difficult to sublet given both the size of the space and its location. Failure to sublet the first floor dramatically changes the cash flow calculations.

If the Council is able to sublet the first floor space as well as the other leasable areas of the building, there will be ten years out of the twenty five year period on which the cash flow projections are calculated during which the Council will be required to subsidise the running costs of the building. These range from £7,400 to £232,600 in any one year. The cumulative revenue cost to the Council over a 25 year period would be £167,000.

If the first floor does not let, the Council will be required to subsidise the running costs of the building every year. The level of subsidy ranges from £1,525 to £213,500 in any one year. The cumulative revenue cost to the Council over the 25 year period on this basis would be £1,670,000.

It is important to note that these figures are provided on the basis of information currently available and many assumptions have had to be made in formulating the cash flow projections. The calculations also reflect current economic and market conditions. Should there be a significant improvement in these areas, the actual cash flow position could improve.

STRATEGIC CONTEXT

21. Ryde Gateway has previously been identified as an important regeneration project for Ryde and the Isle of Wight. It is identified as a transport hub in the South East Plan and also forms part of the 2002 and 2006 Local Transport Plans.
22. Construction of Ryde Gateway was seen as creating a landmark focal point for arrival on the Island, thereby enhancing tourism and the economy. It was hoped that it might attract further inward investment and regeneration opportunities in Ryde.
23. The current station and land is owned by Network Rail, who in turn lease the station building to the train operating company, Stagecoach South Western Trains Limited. The Council has no responsibility for the existing station building. The Ryde Gateway building will occupy a larger footprint to include land owned by the Council, however the ownership of the building will remain with Network Rail and the Council will become Network Rail's tenants subject to Network Rail being able to terminate the lease on six months notice at any time.. The Council would in turn, and in agreement with Network Rail, sublet retail floor space in the new building. The Council would retain all risk associated with building the Gateway building and its ongoing maintenance and operation.
24. The cost of constructing the Ryde Gateway building has increased significantly from initial estimates. The total build cost is now projected to be approximately £10,465,000. Should the project go ahead, the Council's contribution will also have increased significantly to £4,025,000.
25. As stated above, the existing station building is not owned by the Council, nor do we have any responsibility for its upkeep. Should the project progress, the Council will be required to spend in excess of £4 million from its own resources on an asset which does not currently belong to us and will not on completion of the project. The Council will also retain the ongoing maintenance liability associated with running the building. The existence of the six month rolling break clause adds further uncertainty and risk to the future revenue implications of this project.
26. The benefits of the project stated above are aspirations which are neither tangible nor easily quantifiable. In light of this and the financial impact of the project on the Council's resources, there is a strong argument that the cost of this project now exceeds any perceived benefit and therefore that the Ryde Gateway project no longer demonstrates value for money.

27. If it is decided that the project is halted it is recommended that consideration is given to using the additional capital allowance of £1,500,000 agreed in September 2008 on improvements to the public realm and Council assets in Ryde. This would mean that the Council would be using its resources to improve public assets and areas for which we are responsible rather than spending money on an asset that does not belong to us. The Council would consult with the relevant Ryde Ward members and Town Council on any proposed schemes.
28. The Ryde Interchange Project is not critical from the point of view of The Island Plan Core Strategy and a delay or halting of the current proposal would not prevent development within the Ryde area from occurring.
29. Government Office For The South East (GOSE) has recently written to the Council confirming that it is unlikely that funding will be available from the Regional Funding Allocation for schemes of this nature within the next ten years or so. However, given that the actual building currently does not and in the future would not belong to the Council, this will be a matter for Network Rail to address as it is their asset.

GOSE has further indicated that, should the Council choose to progress the project, we could undertake a further cost benefit appraisal and on the basis of this apply to the DfT for additional funding to cover the shortfall between the original grant and the current projected cost of the project. There is, however, no guarantee that the DfT would fund the additional costs regardless of the outcome of the revised appraisal. In order to undertake a further benefit cost appraisal the Council would have to appoint consultants to undertake this work on our behalf as we have neither the skill nor capacity to do so. This would require additional unbudgeted for expenditure. Even were the DfT to provide additional funding, this would not address the long term issue of the cost of maintaining and managing the gateway building once built.

The above option is not considered feasible at this late stage given that it would be several months before a revised appraisal could be submitted to the DfT and a decision made. This would mean further delays and the associated cost with no guarantee of a favourable outcome. In addition and as stated above, it does not relieve the Council of the ongoing maintenance and management responsibilities.

CONSULTATION

30. Extensive consultation has previously taken place with all stakeholders regarding this project. The contents of this report as well as the decision taken by the Council's Cabinet will be consulted on with the relevant Ward Members and the Town Council.
31. GOSE and the DfT have previously supported this project and continue to do so. They do, however, understand the difficulties that have been experienced and the effect of the delays on the overall cost of the project.

FINANCIAL / BUDGET IMPLICATIONS

32. Should the Ryde Gateway project continue the Council will be required to find capital funding of £4,025,000. This represents an increase of £734,000 on previous estimates. In addition, the Council will need to make provision for ongoing revenue implications of between £167,000 and £1,670,000 over a twenty five year period.

33. As at the end of July 2009 £1,558,482 in capital had been spent on the Ryde Gateway project. Of this, £612,360 has been spent against the DfT grant. In addition, the DfT had contributed £243,879 to the preparatory costs of the project. The council has also spent £102,516 in revenue on this project.
34. Should the Council decide not to proceed with the Ryde Gateway project it would be required to reimburse the DfT £856,239 (£612,360 + £243,879). The DfT has offered to reduce the Local Transport Plan (LTP) settlement figure by this sum over two years, thereby minimising the impact on the Council's budgets.
35. The cost to the Council of halting this project would therefore be £1,558,482. After the £612,360 recouped by the DfT, £946,122 will need to be written off as abortive expenditure. This would need to be met from the Council's revenue budgets.
36. As stated above any decision to halt the project would include a recommendation that consideration be given to reallocating the £1,500,000 additional capital allocation agreed in September 2008 to undertake works on the public realm and Council assets in Ryde.

LEGAL IMPLICATIONS

37. There is no formal signed Agreement between Isle of Wight Council and Network Rail, South West Trains or Island Line. The Council's position in the case of the project being halted would be that, at this stage, all preparatory costs of the parties would be met by the individual parties. The Asset Protection Agreement (APA) that Network Rail requires us to sign before proceeding with entering into the Lease is the document that would set out between us and Network Rail the Agreement in relation to costs. The APA has not been signed and there is currently therefore no formal Agreement between us and Network Rail as to costs.
38. With regard to Wightlink and Hover Travel, the Solicitors acting for those companies sought agreement in the early stages that the Isle of Wight Council meet their clients' costs. These costs have been accounted for and are not expected to exceed £10,000.
39. With regard to Southern Vectis, they did not seek any undertakings in relation to their costs and we have, of course, more recently entered into a Licence for the use of the Bus Station so that arrangement has been put on a formal basis, defining each party's responsibilities. Again, in the absence of undertakings, each party is responsible for their own costs. The Council has covered all costs in relation to the Licence and are not expected to have any further liability to Southern Vectis costs in connection with this matter.
40. Effectively, with the exception of Hover Travel and Wightlink, all parties have been negotiating at their own risk.

EQUALITY AND DIVERSITY

41. The Ryde Gateway Project was established in 2002 and as part of the LTP process would have been subject to an equality impact assessment. However, it is recognised that a number of changes have taken place to the project and that changes have been made to the equality and diversity legislation. Therefore, should the project progress, a current equality impact assessment should be carried out.

OPTIONS

42. Option 1
Cabinet agrees to allocate an additional £734,000 from its budgets to enable the Ryde Gateway Project to be implemented.
43. Option 2
Cabinet agrees to terminate the Ryde Gateway Project and, in doing so, agrees to give consideration to allocating £1,500,000 to undertake improvements to the public realm and Council assets in Ryde, aligned with the Council's corporate priorities, following consultation with the relevant Ward Members and the Town Council.

RISK MANAGEMENT

42. The key risks to implementation of the Ryde Gateway Project (Option1) are:
- The risk that further increases in project and construction costs will impact the affordability of the project
 - The risk that the expected return on investment (which is currently projected to be too low to be commercially acceptable) may not be achieved as a result of reduced levels of tenancy take-up and rental income stream.
 - The risk that, following completion, circumstances arise causing Network rail to exercise the six month rolling break clause.

The key risks to termination of the project are:

- Loss of the benefits which were anticipated to be delivered by the project from the enhancement of the transport interchange.
- The impact of repayment of the DfT monies abortive costs on the council's budgets and the loss of the projected revenue from the ongoing operation of the Gateway facilities.
- Potential impact on the Council's reputation as a result of a perceived failure to successfully deliver a key project.

RECOMMENDATION

44. It is recommended that Option 2 is implemented:
Cabinet agrees to terminate the Ryde Gateway Project and, in doing so, agrees to give consideration to allocating £1,500,000 to undertake improvements to the public realm and Council assets in Ryde, aligned with the Council's corporate priorities, following consultation with the relevant Ward Members and the Town Council.

APPENDICES ATTACHED

CONFIDENTIAL

- 45. Appendix A – Liability Issues
- 46. Appendix B – 25 Year Cash Flow Projections

BACKGROUND PAPERS

- 47. Delegated Decision 26/07 “Ryde Interchange – Approval to Construct”.
http://www.iwight.com/council/what_is_a_council/images/2RydeInterchangereport.pdf
- 48. Delegated Decision 18/08 “Ryde Gateway – Approval to Accept Government Funding to Support the Development of the Scheme”
http://www.iwight.com/council/what_is_a_council/images/RydeGatewayReport2.pdf
- 49. Cabinet Report – “Ryde Gateway – Decision to Proceed 9 September 2008”
<http://www.iwight.com/council/committees/cabinet/9-9-08/Paper%20H.pdf>

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