Independent consultant Michael Schabas, formerly transport vice president of Olympia & York, reveals the secret battles that the Canary Wharf developer had with London Regional Transport. This account, "Jubilee Line Extension: The inside story", was presented as a paper to a Bow Group conference in London last week.

BURNT OFFERING

The Jubilee Line Extension is one of the more unusual examples of public-private finance. It was the product of unique circumstances in a time that is now past. Yet the tale of how £150M was extracted from Canary Wharf to help finance a new tube line has lessons for anyone attempting to create a public-private partnership.

Specifically it shows that:

- Government is severely constrained when negotiating agreements with private partners. It is almost impossible for ministers to behave commercially, even if they are so inclined;
- Conflicting agendas of ministers, government departments, and nationalised industries can result in long delays and missed opportunities. Public sector agencies often lock themselves into developing and promoting the wrong schemes. By injecting more pragmatism into the scheme development process, taxpayers and consumers will ultimately benefit from early involvement of the private sector;
- Even where private investors take only a minor share in project funding and risks, they are a valuable indicator that a scheme is sound and brings real value.

To the credit of Government, many of the lessons of the Jubilee Line seem to be reflected in the terms now being proposed for Croydon Tramlink, the Docklands Light Railway Lewisham Extension, Union Railway, and West Coast Main Line projects. If there had been a private finance initiative in 1988, the story of the Jubilee Line might also have been very different. Negotiations would probably have concluded more quickly, public financial exposure would be less, and indeed trains might already be running from Westminster to Docklands. On the other hand, without the lessons of the Jubilee Extension, these other projects might not be so far advanced.

Before getting into the inside story of the Jubilee Line negotiation, it is first worth reviewing the background to the Canary Wharf project.

The Reichmann family, Canadian owners of Olympia & York, were and indeed still are very successful developers. In 1987 they were lured to Docklands by the offer of 28ha of waterfront land at Canary Wharf, within 3km of the City of London.

As well as tax incentives and planning freedom, the Government also promised various transport improvements. The DLR would be extended to Bank, with capacity quadrupled, in return for a £68M cash contribution. This was paid by O&Y, on the nose, in July 1987. This may well have been the largest private contribution to a railway project in modern times, that is apart from the Jubilee Line contribution which was to follow.

The road system in the area was also to be greatly improved, with the Limehouse Link and other new roads creating a fast dual carriageway to the M25 and back into the City. The East London River Crossing and Hackney M11 link were also to be built by 1992. On this basis, Paul Reichmann did not expect transport to be a serious problem when he began construction of the project. He was soon to learn otherwise.

First, he discovered that London Transport could not fulfil its obligation to upgrade the DLR. The Bank extension opened in 1991, about six months late, but massive reliability problems delayed the committed increase in capacity. The funding agreement for which O&Y paid £68M had promised trains from Bank to Canary Wharf every four minutes; the best that is currently offered is an eight minute frequency. A four minute frequency is unlikely to be achieved before this summer, some three years late. But that is another story.

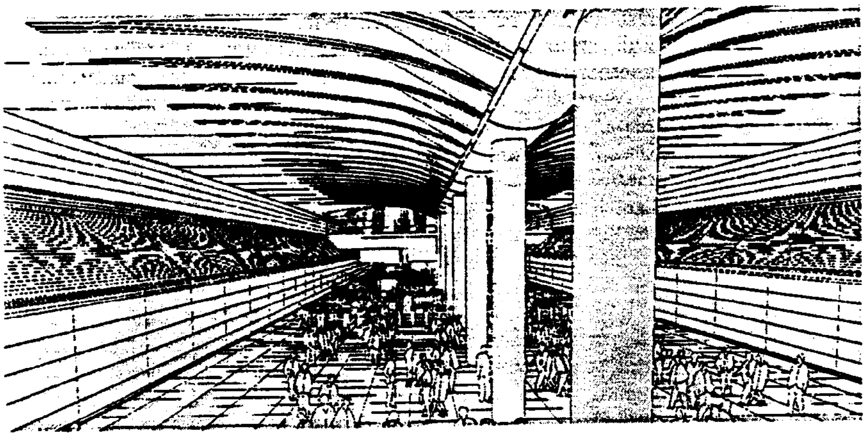
Second, Mr Reichmann belatedly took a lesson in London's geography. The DLR, when finally upgraded, will provide ample capacity and also has very good connections to the Central and Northern lines. But for Canary Wharf to compete with the City and West End, it needs better connections for the many senior staff who live predominantly in west London. In New York, Toronto, or San Francisco, where O&Y has previously built off-centre developments, senior managers can always revert to driving on the freeway, although significant numbers do still travel by rail. But inner London does not really have a motorway system, and driving from say Haslemere to Docklands just isn't very attractive.

So as the first piles were being driven for the 50 storey tower at Canary Wharf, in spring 1988, O&Y was asking Government and LT what it would take to get a second rail link, perhaps to Waterloo and the West End. Reichmann was also building up an in-house transport department, to help plan and build the new line. This was when I joined the project.

In the summer of 1988 we made a firm proposal to build a new line, dubbed the "Waterloo & Greenwich Railway" which would link Waterloo to Canary Wharf. It would continue east to the Greenwich Peninsula, about 80ha of derelict land which was then on offer by British Gas as a large development site. This new, deep tube line would be designed for future extension under the West End, and in the east on to Stratford or Thamesmead.

We were interested of course primarily in the Waterloo-Canary Wharf link but recognised the need to fit the scheme into a sensible overall development strategy. We even proposed integrated development around other stations, at the Surrey Docks and on the Greenwich Peninsula. We quickly took an option on the Surrey Docks from the London Docklands Development Corporation, and made a serious cash offer to buy the Peninsula from British Gas.

The initial reaction of Government was very positive, partly, I am sure, because it saw many other benefits in improving access to depressed parts of south and east London. It was no accident that we proposed a solution which met our own needs but also suited the Government's regeneration agenda.



Jubilee Line Extension's Canary Wharf Station, at last under construction.

LT's reaction to our proposal was, however, somewhat less positive. This was, apparently, because our proposal was seen as conflicting directly with its own ambitions, to build another scheme called CrossRail.

At that time, both O&Y and LT were caught up in the euphoria of the late 1980s boom. Office space in the City was going for record rents of £70 a square foot. Commuting and crowding on London's Underground was at an all-time high. O&Y responded by investing £1500M on 5M square feet of office space, hoping to get £30 to £40 per square foot.

LT's response, in the Central London Rail Study, was to revive a scheme dating from the 1940s called East-West Crossrail. This scheme to link Paddington and Liverpool Street had been studied many times before, but the numbers had never stacked up. With the prospect of massive employment growth through to the end of the century, LT was at last able to predict a positive benefit-cost ratio for the project and government approval seemed achievable.

With hindsight, it is fairly easy to judge the commercial wisdom of O&Y's investment. The banks have now written off some £1500M of debt, and rents at Canary Wharf are again in the £5 to £10 range. We all make mistakes!

O&Y's scheme for the Jubilee Line Extension, which would divert traffic around central London, was seen as a threat to CrossRail because it would compete for the same political support and the same parliamentary time. It would also achieve some of the same objectives. By extending the line on to West Ham and Stratford, we suggested, it could provide a route around the congested city, relieving the Central Line through Liverpool Street. In retrospect, this was a serious tactical error on our part.

Through the summer of 1988, we put together a Parliamentary Bill for the Waterloo & Greenwich Railway, completing all necessary documentation and even preparing a Book of Reference. To get greater confidence in our cost estimates, we paid five contractor consortia, including Trafalgar House, Hawker Siddeley, Balfour Beatty, and Amec, to prepare turnkey bids. Again, dealing directly with contractors, suggesting that LT had no monopoly on railway building skills, was seen as a particular affront and won us few friends at 55 Broadway.

The bids for the Waterloo & Greenwich Railway came in at about £450M. Allowing a year to get the necessary Parliamentary powers and four years for construction, we expected completion in early 1993. To speed the project along, O&Y was prepared to make a very substantial contribution and also, critically, share in the risks, including any overruns and any operating losses. Government's share would be relatively small, with an option to take over the line later if desired, at no cost.

We actually got as far as drafting heads of terms for a joint venture with LT. But LT still did not warm to the idea of building new tube lines across London with Canadian developers. Of course in return for an open ended commitment to cover any cost overruns, we were insisting on a share of the project management. In any case, LT advised Government to reject our proposal, arguing on the basis of some very quick modelling work that the public benefit did not even justify the modest public investment we were suggesting.

Government officials reluctantly declined O&Y's offer. They had no choice. They were captive to the "experts" at LT. However much they might question the wisdom of turning down such an attractive proposal, the risks of taking a decision "on instinct", against the advice of a statutory body, are just too high for civil servants who are subject to audit committees and such. Ministers too were less than pleased. The best they could do was insist on an "East London Rail Study", prepared by someone other than LT, to determine the best route for a new rail line to Docklands. ELRS was also to determine the "funding gap" after allowing for social benefits, which would then set the required private contribution. In any case, a year was lost, and an offer that would later be seen as very attractive was turned down flat.

The consultants appointed to conduct the East London Rail Study quickly realised that, to be of interest to Docklands, the line needed to connect Canary Wharf to the West End, and suggested an extension of the Jubilee Line.

They also quickly saw the merit of extending the line on to Stratford, relieving congestion on the Central Line and creating new river crossings.

Between London Bridge and Green Park two routes were identified. LT preferred a line on the north side of the river via Fleet Street, connecting into the Jubilee Line at Charing Cross. This was, after all, the last bit of tube built in the 1970s before they ran out of money, so there was considerable emotional support for finishing off the job that had begun many years before.

Others argued that needs had changed, and a connection to Waterloo was now very important. The Jubilee Line had been planned back in the 1960s to go to Thamesmead, bringing workers to jobs in the City and West End. Now we needed a line that would also take commuters back out to Docklands. Almost a third of City workers come through Waterloo, so if companies were to move from the City to Docklands, a connection there was particularly important. A route along the South Bank would also be easier to build and potentially a bit cheaper. Support from the LDDC was particularly helpful in this debate.

ELRS finally reported in the summer of 1989. To their credit, the "independent advisors" acknowledged that the preferred scheme, a £900M extension of the Jubilee Line from Green Park via Waterloo, did have substantial public benefits and would be one of the most heavily used tube lines in London. Indeed, the cost-benefit ratio was at least as good as for the CrossRail scheme or its rival the Chelsea-Hackney tube. Besides attracting heavy peak traffic to Docklands, the line would materially relieve central London congestion by diverting passengers off the Central and District Lines in the east. It would also attract substantial all-day traffic, in particular to the new international rail terminal at Waterloo. The short section of line built through Charing Cross in the 1970s would be abandoned.

The new Jubilee Extension would also support development in Docklands. The Government's advisors on this were Drivers Jonas, who apparently advised that property values along the route would increase by more than £1000M. But nobody came up with a good idea as to how to capture any of this, with two exceptions. First, Government could try to hold O&Y to ransom, and stated that unless £600M was forthcoming the line would not be built.

Government also tried to hold an auction further east, offering routes via the Greenwich Peninsula or Leamouth depending upon which landowners would make a better offer. British Gas won with an offer of £25M, although there are now rumours that the deal was never quite consummated and British Gas may end up getting the station for free.

LT then argued that it was too late to prepare a bill for submission that year, but on this Government overruled and insisted that a joint team be set up with O&Y involvement. We pushed hard and had everything ready for the November deadline. At the same time, LT also had a team preparing a bill for CrossRail, although that bill was not ready for another two years.

Meanwhile, negotiations began to determine the appropriate contribution from O&Y. At that time, we did feel that Government had rather overplayed its hand. We prepared our own analysis to show that, using more modern technology, the scheme could be built for only about £700M. Of this, about £500M could be recovered by fares, net of operating costs, with a further £400M in road user benefits. We felt that the strong cost-benefit ratio meant that no private contribution was actually required. We suggested, half in jest, that according to the terms originally suggested for ELRS the Government now owed us money for coming up with such a great scheme!

Although Government had announced an intention to seek £600M from the "private sector", our own hand was fairly strong. Unless the Jubilee Line went ahead, they would be under pressure to fund the CrossRail project instead which had not attracted any private funding interest whatsoever and which also had a weaker economic case.

O&Y also had little appetite for the risks associated with the project. Fortunately for O&Y, but alas not for Government or the taxpayer, LT had no interest in sharing these risks either. Various schemes were put forward for O&Y involvement in the project management, but these were not taken up. In the end Government and O&Y agreed to a fixed contribution. This was nominally £400M, although because much of it would only be paid after the line was completed, the effective value is only about £150M.

So far the scheme had been delayed one year, the value of O&Y's contribution had fallen substantially, and the potential for project risk transfer had been lost. More was to come.

LT then insisted on taking control of the design process and promoting the Parliamentary bill. Since there was still only lukewarm enthusiasm within LT for the scheme, it was managed on a very loose rein mostly by outside consultants.

Perhaps predictably, cost estimates rose towards £1700M, mostly as designs were enhanced to provide for ambitious traffic growth estimates and to satisfy a desire to make the line into an architectural showpiece. Some of us were, frankly, appalled to see costs climb so sharply. Most expensive does not always mean better, and it was troubling to see costs of individual stations topping £100M when equally attractive schemes had been developed for half this price. Again, Government had difficulty arguing with LT which insisted that larger and more expensive stations were necessary to meet modern safety standards.

For various reasons, LT took a further two years to get the bill through Parliament; this for a scheme that is virtually all underground, taking not a single house. In the 1930s LT regularly promoted major bills in a single Parliamentary session. By the time of Royal Assent, in early 1992, the Canary Wharf tower was finished but O&Y was in financial trouble and could not longer come up with the first £100M instalment.

Government enthusiasm for the project diminished as the costs increased. But it stuck to its word and agreed that if the Canary Wharf banks could come up with the required payment, they would give LT the money to proceed with the project. Eventually they did.

This show of confidence in both projects, the Jubilee Extension and Canary Wharf, is perhaps the most remarkable chapter of the whole story but alas it is too recent to be told. Suffice to say that a £100M contribution is a pretty strong indication that the Jubilee Line will bring massive benefits, not just to Canary Wharf but to much of inner south and east London. Construction has now begun, and the line should open in 1998.

What has been learned? Although competition is still seen as the best way to ensure value for money, Government is more flexible in how the test is applied. It also recognises the value of private involvement early, during the project definition phase. Croydon Tramlink is using an innovative project development approach, which may be the model also for promotion of the Union Railway.

Government now readily seeks independent advice and is breaking apart the nationalised industries to increase accountability. With the restructuring and privatisation of the railway industry, no single body will be able to claim a monopoly on technical knowledge. Ideas and investment schemes now need to stand up to external scrutiny from competing groups.

Government continues, properly, to attach great importance to private participation in projects. Even when the actual amount of money put at risk is fairly small, private participation is a good indication of scheme value and also tends to bring tighter control and project management.

New agencies such as Railtrack are explicitly charged with behaving in a commercial fashion, with the motivation and confidence to make commercial deals. Perhaps inevitably, Government still makes decisions rather slower than private investors, and cannot easily "seize the moment".

In the unique circumstances, O&Y's offer was very real and would have brought great benefits. By the time Government had made up its mind circumstances had begun to change. Offers do not stay on the table for ever.

In retrospect, it was tragic that O&Y's original offer was turned down. Even had O&Y still gone bust, London would have got a new tube line for a fraction of the full price. Private involvement would certainly have speeded the project along and helped keep costs under control.

But without support from LT's leadership, and without some sort of competitive price check, Government officials lacked the confidence that it could defend O&Y's offer as a good deal.

CONSTRUCTION WEEKLY

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LT rejected cheap tube alternative to Crossrail

FOUR major contractors each submitted turnkey bids to Olympia & York for a railway linking the West End with Docklands — for a quarter of the cost of the Jubilee Line extension, writes **Dominic O'Connell.**

Amec, Hawker Siddeley, Balfour Beatty and Trafalgar House had been paid by O&Y to compile the bids as part of a plan to form a joint venture with London Transport to build a tube line to Canary Wharf, former O&Y adviser Michael Schabas told a conference last week.

But the deal fell foul of opposition to a private-sector partnership "at the highest levels of LT", and LT's commitment to the rival Crossrail project.

Not only was the 1988 scheme significantly cheaper than the current Jubilee Line extension, Schabas said, but it suggested that a large share of the construction costs might be met by O&Y. The property developer had also offered to share all the project's revenue risks.

"If the private finance initiative had been in place in 1988, the line would already be operating. O&Y would probably still have gone bust, but the line would be there," Schabas said.

The Reichmann brothers, the Canadian developers behind O&Y, had underestimated transport problems at Canary Wharf. "In the Docklands Light Railway you had something that looked like a transport system. It was good enough to attract the O&Y investment. But that was all it was," he said.

O&Y had progressed as far as signing heads of agreement for a new tube line with LT. "But they did not warm to the idea of building new tube lines across London with Canadian developers ... we were insisting on a share of the project management, which they did not like," he said.

Schabas said the government appeared to have learned from the lost Docklands tube opportunity. "They are now much more open to the private sector. And if they have a public body that isn't, they replace it with one that is — as in the case of Railtrack."