



The Rt Hon John Major MP
Chief Secretary
HM Treasury
Parliament Street
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My ref:

Your ref:

NBPM at this stage.

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19 February 1988

Dear John

LDDC: DOCKLANDS LIGHT RAILWAY, EASTERN EXTENSION

I am writing to let you and colleagues know of the arrangements I am agreeing with the London Docklands Development Corporation to fund the Eastern Extension of the Docklands Light Railway. My officials have consulted yours extensively about this, over the last year.

You will recall our discussions at E(A) late in 1986 and early in 1987, when we agreed in principle to the eastern Extension of the DLR, including the principle that it would be financed in ways that did not add to public expenditure. The Prime Minister summing up at our first discussion said that the project would proceed with financial support from the developers, provided that there would be no significant risk that any of the costs would fall on LRT.

I have considered four possible ways of funding the Eastern Extension -

- a. a "simple" method, whereby the Corporation would match land disposals to the capital requirements of DLR construction;
- b. re-ordering LDDC's programme, to accommodate the DLR, at the cost of delaying other projects;
- c. an increase in LDDC's resources;
- d. or a funding vehicle.

Option (a) would not give us value for money, since LDDC would be required to make significant asset sales early in the life of the project, and so lose very substantially on the expected enhancement in land values which redevelopment of docklands and the Eastern Extension will bring. In looking at New Town disposals, NAO (and the PAC) have made clear their aversion to anything smacking of forced sales before the assets are mature.



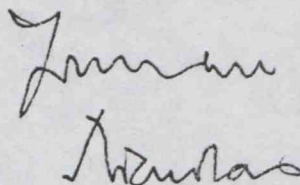
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I do not regard it as practicable to defer other items in LDDC's programme - option (b) above. I would have to defer major projects in the Royals, which would seriously damage our policy objectives and developer confidence, including proposals related to Canary Wharf. Increasing LDDC's resources - option (c) - would, of course, run contrary to our decisions at E(A) and in the last public expenditure round. Nor do I believe that overall this option offers better value for money than option (d), the funding vehicle.

Accordingly, I am satisfied that the use of a funding vehicle is the best way forward. LDDC will set up such a funding vehicle with financial institutions, who will own it. There will be a drawing facility, for the full amount needed to pay for the construction of the railway. As security for that, LDDC will transfer to the funding vehicle the minimum possible land bank which will be acceptable as cover. Interest rates on drawings under the facility will be above NLF rates, but only about 1% over base rates. The funding vehicle will pay for the construction of the railway in tranches, by selling off parts of its land bank, when it represented good value for money to do so. The funding vehicle would take the major risk of land prices not reaching the expected increases in value which we look to materialise. When construction is complete, the land remaining in the land bank will revert to the Corporation, for them to dispose of as they see fit.

I am satisfied, and I understand that your officials are as well, that in principle this will provide for sufficient transfer of risk to the private sector. My officials, will, however, continue to liaise with yours, and with LDDC's auditors, to make sure this is so. We will also be looking to ensure that the substantial involvement of the private sector gives the efficiency gains required.

I am copying this to the Prime Minister, other members of E(A), and to Sir Robin Butler.



NICHOLAS RIDLEY