

# HAMPSHIRE COUNTY COUNCIL

## Decision Report

<b>Decision Maker:</b>	Executive Lead Member for Economy, Transport and Environment
<b>Date:</b>	12 May 2022
<b>Title:</b>	The Impact of the Inflationary Pressures on the Delivery of the Highway Maintenance Service
<b>Report From:</b>	Director of Economy, Transport and Environment

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### Purpose of this Report

1. The purpose of this report is to provide the Executive Lead Member for Economy, Transport and Environment with an update on the evolving impacts across the highways service of rapidly rising costs and the increasingly limited availability of key materials as a direct consequence of the current global situation. The report recommends that normal highway maintenance services are sustained as far as possible to ensure the decline in the condition of the highway network is not worsened. This will require an urgent reprioritisation of funding to ensure critical activities can continue to be sustained.

### Recommendations

2. That the Executive Lead Member for Economy, Transport and Environment notes the increasing inflationary pressures and associated impacts on the costs of planned and reactive highways maintenance works in 2022/23, principally as a consequence of the current global situation.
3. That the Executive Lead Member for Economy, Transport and Environment approves the re-direction of up to £3.5million of revenue funding from the additional £7million that was agreed by the County Council in November 2021, to cover the additional costs anticipated in delivering the planned 2022/3 Structural Maintenance Programme, as a one-off single year revision to the annual spend programme that was agreed in March 2022, as part of the Highway Network Recovery Strategy.

### Executive Summary

4. The current situation in eastern Europe has resulted in significant and rapid increases in the cost of oil, gas and energy which have impacted manufacturing and global supply chains. These were already in a state of managed recovery following the impacts of Brexit and Covid.

5. The total estimated pressure on the highways maintenance service for the financial year 2022/23 could be in the region of £3-4.5million, and possibly higher as the situation is still evolving. This includes an additional £1million revenue pressure for routine and cyclic operations that will also be impacted by rising costs.
6. A number of options have been considered to manage the risks and anticipated impacts arising from the pressures, including reducing the planned maintenance programme significantly to bring the programme within the current budget, and reducing elements of the routine and reactive highways maintenance work to essential emergency and safety defects only. However, to reduce the programmes and service in this way would have a significant detrimental effect on the condition of Hampshire's highway network and would inevitably result in continued accelerated decline.
7. It is therefore proposed to continue delivering basic highway maintenance services as normal with financial support redirected from the additional funded activities, identified as part of the additional £7million package of works for the 2022/23 financial year, to planned structural maintenance (Operation Resilience), and specifically the surface treatments programme, to offset the increased costs.
8. This departure from the agreed Highways Network Recovery Strategy is proposed as a one-off arrangement for 2022/23, and future programmes will be planned on the basis of the original cash limits for Operation Resilience from 2023/24 onwards. However, the position in respect of construction inflation will be kept under review, particularly in the context of the current Government funding announcement of a flat three-year allocation for Highways Maintenance up to 2025/26. A further report will be brought forward later in the year, if it is considered that the Highways Network Recovery Strategy should be permanently revised.

### **Contextual information**

9. The challenges and pressures affecting the highway maintenance service have been explained in detail in previous Decision reports; *Hampshire Highways Service Update*, 29 July 2021 and *Hampshire Highways – Highway Network Recovery Strategy*, 10 March 2022. These reports have highlighted that the main problems in Hampshire have been predominantly due to the increasing deterioration in the network condition following many years of under-investment in local roads maintenance from central Government. In light of the additional £7million of funding allocated to the Highways service in November 2021 the March Decision report recommended an investment strategy to address these issues. At the time of that report, it was known that the value of the extra £7million funding would be diminished by inflationary pressures such as the National Insurance increase and the limitations on red diesel use, which were already starting to become evident in the construction industry. However, this report details how these pressures have become significantly greater and more acute since the previous report was drafted and considered, and therefore proposes further temporary measures to address the changed circumstances.
10. The construction and highway maintenance industry continues to exhibit strong evidence of instability on the back of Brexit and the Covid pandemic with

inflation indices increasing as a consequence. Additional cost pressures have followed, along with the anticipated changes in legislation for “red diesel” and national insurance contributions, which came into effect from April 2022. However, the recent events in eastern Europe are now having a very significant and alarming impact on top of these existing challenges which has intensified the financial situation with inflationary pressures now evident in many areas.

11. The total pressure on the highway maintenance service for the 2022/23 financial year is forecast to be £3-4.5million, and this could increase if the Ukraine situation continues to deteriorate, further impacting supply chains and costs. This includes a potential ‘additional’ £1million inflationary pressure over and above the £3.5million pressure already identified for planned structural maintenance (Operation Resilience) for routine/cyclic revenue activities which have also been impacted by rising costs, many of which have already triggered contractual early-warnings and/or compensation events.
12. The Ukraine situation is already impacting national, international and pan-European material supply-lines, particularly for bituminous-based products, but all areas of construction activity are currently experiencing volatile changes in prices, costs and risk profiles. In a worst-case scenario this has the potential to have a greater financial impact on the delivery of the highway maintenance service than the Covid pandemic did.
13. The duration of the current situation is unknown, which will ultimately increase the risk profile of highway maintenance activities still further, and also impact unit prices.
14. Oil and gas prices are unstable and rising rapidly, and this directly affects fuel, energy, manufacturing, and also overhead costs. Bituminous products, i.e. asphalts, bitumen binders etc., are already being heavily impacted. Costs are continually increasing with asphalt suppliers no longer honoring guarantees on prices and refusing to provide new ones beyond a few days. The highways surface treatment annual programme, i.e., surface dressing, resurfacing etc., is currently approximately estimated to increase by circa £3million for 2022/23, but the figure could be higher because of the continuing uncertainty. The barrel price of oil is a key factor and this has nearly doubled in some markets. All areas of the highways service are anticipated to be affected by the broad increase in costs, but planned structural maintenance (Operation Resilience) activities are anticipated to be the most impacted as a high proportion of this work relies on bituminous materials.
15. Early warnings have already been issued by the County Council’s term highway maintenance contractor, Milestone Infrastructure Limited, and its larger supply chain partners, all raising very significant concerns about unsustainable cost increases. So far only a few key suppliers have provided indicative cost estimates, but this is anticipated to change over the coming weeks. Milestone Infrastructure has written to all members of its supply chain asking them to clarify their forecast position and whether they are experiencing financial difficulties. This is not intended to encourage contractual claims but instead to avoid the prospect of suppliers becoming insolvent, which will consequently affect service delivery.
16. Other national issues such as driver and labour shortages have continued to impact the sector and are creating further commercial and financial instability.

17. The challenge for the highway service is how long these increases can be sustained. Whilst frontline statutory services clearly need to be protected, the reality is that less proactive work may be completed on the ground due to material and labour costs and availability.
18. The Hampshire Highways Service Contract affords the County Council a degree of protection against dramatic price/cost increases. However, given the desire to preserve the collaborative relationship with Milestone Infrastructure, and the wider supply chain, the County Council has continued to react sympathetically to any early warnings or compensation events and, where appropriate, has reviewed payment mechanisms to ensure contractors and sub-contractors can remain solvent. The alternative, less desirable, solution is to reduce non-emergency and non-safety related works until the situation improves. Whilst this would minimize the inflationary and financial impact, there would be further deterioration in the condition of the highway network and also an increase in the backlog of maintenance work at a time when planned work is normally ramped up to take advantage of more favourable weather. Although a reduction in the work delivered would provide a saving, it is likely the contractor would be entitled to claims for compensation where costs have been incurred, therefore the savings would not necessarily reflect the full cost of the work aborted. There is also a public expectation of increased works as a result of the recent confirmation of the additional £7million annual funding.
19. Highways officers are continuing to work very closely with the County Council's delivery partners and supply chains. However, this active engagement will only serve to try and mitigate cost increases and sustain day-to-day delivery, and it will not stop them going up.
20. The *Hampshire Highways – Highway Network Recovery Strategy* report approved in March 2022, identified that the County Council has an estimated highway maintenance backlog of £377million, with £278million associated with carriageways and footways. Therefore, to maintain the Asset Management-driven strategy for highway maintenance it is considered imperative that planned structural maintenance (Operation Resilience) activities are sustained, which provide the optimal solution for maintaining and improving highway condition and ensuring cost efficiency. Reducing these work programmes would inevitably lead to an increase in highway defects such as potholes, and also an increased need for inefficient and costly reactive repairs.

## **Finance**

21. The Highway Network Recovery Strategy indicated how the additional £7million of funding would be allocated for the 2022/23 financial year, with a strong emphasis on revenue funded activity in the early years of the strategy period. However, due to the immediate pressures outlined in this report, it is proposed to cover the increased costs for planned structural maintenance (Operation Resilience) from this additional £7million for this year only, as a one-off, acknowledging that this will subsequently reduce the quantum of additional non-safety related revenue funded work that was planned to be delivered from this new funding, e.g. sign cleaning, vegetation clearance, ditch/grip clearance and additional grass cutting etc. Whilst some additional revenue activity will still be

delivered in 2022/23, such as drainage cleansing and localised repairs, it will be at a lower level than indicated in the previous report.

22. The situation will need to be kept under review through the current financial year but, at this stage, it is anticipated that the funding profile for 2023/24 can be broadly as originally outlined in the Highway Network Recovery Strategy. However, given that the Government financial settlement for highway maintenance is flat for the current and subsequent two years, with no allowance for inflation, it is possible there could be sustained high inflationary pressure and this may require a further report to the Executive Member recommending revisions to the Highway Network Recovery Strategy.

### **Consultation and Equalities**

23. Due to the nature of the approval sought for this report, limited consultation has been undertaken. However, the Highway team, Milestone Infrastructure and the wider supply chain are closely involved in actively and dynamically managing this situation and the associated risks and impacts.
24. The decision sought in this report will not reduce the scope of the service provided or have any impact on the individuals working on the service or service users, so has been assessed as having a neutral impact on groups with protected characteristics. Approval is sought for service adjustments to accommodate and address current pressures and it is not anticipated that these proposals will have a direct impact on people with protected characteristics. Rather, they are intended to maintain service delivery to all highway users and help maintain and/or improve highway safety.

### **Climate Change Impact Assessments**

25. Hampshire County Council utilises two decision-making tools to assess the carbon emissions and resilience of its projects and decisions. These tools provide a clear, robust, and transparent way of assessing how projects, policies and initiatives contribute towards the County Council's climate change targets of being carbon neutral and resilient to the impacts of a 2°C temperature rise by 2050. This process ensures that climate change considerations are built into everything the Authority does.

### **Climate Change Adaptation**

26. Despite the change in approach, adaptations will still be made to reduce the highway network's vulnerability to climate change by reducing the impact of flooding on the highway caused by heavy rainfall. Carbon sequestration and biodiversity in highway verges will continue to be increased through enhanced maintenance regimes, albeit at a temporarily reduced level. The investment in proactive planned structural maintenance activities will reduce the number of reactive repairs, which generate additional carbon emissions from transport as well as the works. Increased numbers of repairs also generate disruptions and diversions to the travelling public.

## **Carbon Mitigation**

27. In light of the pressures on bitumen-based products, opportunities will be sought to expand the use of the County Council's highway materials recycling facility at Micheldever to provide more cold recycled materials for use in Hampshire's highway network, reducing the need for traditional hot materials.

## **Conclusions**

28. Previous reports have highlighted the problems associated with the deterioration of the highway network condition. Costs are now increasing, linked to inflationary pressures arising from the global situation, and these will inevitably result in less work being undertaken on the network for the funding allocations that are available.
29. To effectively reduce the deterioration in the condition of the network over time it is imperative that structural highway maintenance operations are sustained as much as possible. These are likely to be the hardest hit area of the service financially, but there is robust evidence that they provide the best value in terms of cost-effective improvements in overall network condition. A higher than originally anticipated proportion of the additional £7million of highway funding, approved in November 2021 by the County Council, is therefore recommended to be reallocated, to planned structural maintenance (Operation Resilience) to offset the increasing costs. This will reduce the proportion of this additional funding that was expected to be allocated to enhanced revenue-funded activity, but it will provide Hampshire with a viable and sustainable solution for continuing to deliver its highways programmes in 2022/23.
30. The ambitions of the Network Recovery Strategy remain unchanged but if the recommended funding transfer is agreed, the approach outlined in the March report will effectively be delayed for one year.

## REQUIRED CORPORATE AND LEGAL INFORMATION:

### Links to the Strategic Plan

Hampshire maintains strong and sustainable economic growth and prosperity:	yes
People in Hampshire live safe, healthy and independent lives:	yes
People in Hampshire enjoy a rich and diverse environment:	yes
People in Hampshire enjoy being part of strong, inclusive communities:	yes

### Other Significant Links

Links to previous Member decisions:	
<u>Title</u>	<u>Date</u>
Hampshire Highways – Service Update	29 July 2021
Hampshire Highways – Highway Network Recovery Strategy	10 March 2022

### Section 100 D - Local Government Act 1972 - background documents

The following documents discuss facts or matters on which this report, or an important part of it, is based and have been relied upon to a material extent in the preparation of this report. (NB: the list excludes published works and any documents which disclose exempt or confidential information as defined in the Act.)

Document

Location

None

## **EQUALITIES IMPACT ASSESSMENT:**

### **1. Equality Duty**

The County Council has a duty under Section 149 of the Equality Act 2010 ('the Act') to have due regard in the exercise of its functions to the need to:

- Eliminate discrimination, harassment and victimisation and any other conduct prohibited by or under the Act with regard to the protected characteristics as set out in section 4 of the Act (age, disability, gender reassignment, marriage and civil partnership, pregnancy and maternity, race, religion or belief, sex and sexual orientation);
- Advance equality of opportunity between persons who share a relevant protected characteristic within section 149(7) of the Act (age, disability, gender reassignment, pregnancy and maternity, race, religion or belief, sex and sexual orientation) and those who do not share it;
- Foster good relations between persons who share a relevant protected characteristic within section 149(7) of the Act (see above) and persons who do not share it.

Due regard in this context involves having due regard in particular to:

- The need to remove or minimise disadvantages suffered by persons sharing a relevant characteristic connected to that characteristic;
- Take steps to meet the needs of persons sharing a relevant protected characteristic different from the needs of persons who do not share it;
- Encourage persons sharing a relevant protected characteristic to participate in public life or in any other activity which participation by such persons is disproportionately low.

### **2. Equalities Impact Assessment:**

The decision sought in this report is will not change the scope of the service provided or have any impact on the individuals working on the service or service users, so has been assessed as having a neutral impact on groups with protected characteristics. Approval is sought for service adjustments to accommodate current pressures and it is not anticipated that these proposals will have a direct impact on people with protected characteristics. Rather, they are intended to minimise disruption to all highway users arising from the current challenges and to help maintain highway safety.