

## **CABINET – 18 September 2018**

### **CASE FOR INVESTMENT TO SUPPORT A SIGNIFICANT INCREASE IN THE COUNCIL'S KEY ASSETS**

#### **Report by the Strategic Director for Communities**

#### **Introduction**

1. Cabinet, at its meeting on 17 July 2018, approved the production of a business case to support a significant increase in borrowing to invest in the Council's assets. If agreed, this additional investment will be managed and governed through the current capital programme.
2. While the focus will be on highways, the principle of the action is to make available funds to invest in the Council's assets where there is significant financial benefit to do so (to avoid deterioration requiring even more expensive solutions in the future), to meet statutory compliance or to meet an emergency need for provision which the current capital programme would struggle to achieve. This report sets out the case for investment.

#### **The Case for Investment**

3. Budgets for maintaining our highways and building assets have reduced in real terms (e.g. 50% in highway maintenance budget) whilst at the same time construction and technical costs have significantly increased. This reduced investment over time coincides with an ageing asset and a decline in condition to a point where the impact of this decline has been more evident and impacting on our residents.
4. Reductions in central government funding has led to a deterioration in our asset condition especially highways (carriageways and footways) but also property (schools and other buildings). In addition, major growth in the county has led to a growth in the asset base to be maintained. This in turn creates additional financial pressures with, for example, increased insurance claims and increased reactive maintenance costs. Currently £10m is spent annually on highway carriageway maintenance and £2.7m on the maintenance of properties: this is insufficient to maintain the current level of condition let alone improve it. In addition, major growth is taking place in Oxfordshire which has the potential to boost funding for the council but will also further affect the use and condition of our existing assets whilst adding to future potential liabilities.
5. Against this backdrop of shrinking grant funding (in relative terms) and significant growth there is a need to address customer concerns over the quality of council owned assets. There is potential to borrow against the future revenue that will be generated by planned growth to increase investment in our assets.

## Benefits of Investment

### Highways Assets

6. The Councils largest and most valuable asset is its Highway and associated infrastructure with a replacement value of £6.2bn.
7. At present the highway network has 10% of roads categorised as having less than 5 years residual life remaining, with a further 45% considered to have between 5 and 15 years residual life remaining. With the current levels of spend the length of roads with less than 5 years residual life is increasing by approximately 25 miles a year and this rate of deterioration is accelerating. Investment at this stage could therefore be invested in cheaper prevention schemes and prevent a significant length of the network deteriorating and therefore reduce the number of costly repairs required in future i.e. prevent the backlog of repairs growing.
8. At current rates of deterioration, it is anticipated that the number of potholes in the county will increase by 32% over the next 5 years. On average Oxfordshire has 35,000 potholes that are considered in need of repair to maintain safety each year, with many more smaller defects that whilst not a risk to safety contribute to the general deterioration of the road. Following winter 2018 however, the number of potholes has risen significantly to 40,630 in the first 6 months alone. An increase in potholes of 32% would therefore have a significant impact on revenue budgets and staffing resources.
9. Investment at this stage would allow repairs to many of those roads already in poor condition, reducing the overall length of network in an unsatisfactory condition. This will reduce the number of potholes that arise and improve the longevity of future repairs in these areas.
10. Early intervention using treatments such as retexturing, micro asphalt or surface dressing can repair minor defects and seal the road surface to prevent water ingress and as a result can significantly extend the serviceable life of a carriageway and prevent those roads from reaching a poor condition. Such intervention can be up to 32 times cheaper than the cost of treating roads in very poor condition representing considerably better value for money. Such preventative treatments have the potential to avoid up to £150m in future costs.
11. Many of the county's footways are in a similar poor state of repair with over 350 miles of footway considered in an urgent need of repair. Insurance claims on footways on average costs the council more per incident than carriageway related claims due to the higher risk of pedestrian injuries arising from footway trips or falls which are more likely to result in broken bones and other muscular/skeletal injuries. In the past few years the council has paid out up to £0.4m per year in insurance claims, however due to the potential of serious injury, particularly in the elderly, individual claims have the potential to be significantly greater than this. Investment at this stage in the most used priority footways would reduce the risk of injury and therefore claims.

12. The County's bridge stock is similarly deteriorating, and over the last few years, weight limits have been placed on several weak bridges, significantly impacting on the flow of heavy vehicles around the county. It is anticipated that many more weight limits will need to be applied over the next decade if strengthening and rehabilitation work is not undertaken. This is likely to restrict traffic movement and has the potential to adversely affect growth within the county, increase congestion and local road issues. Investment at this stage will reduce significant disruption to the highway network.
13. Many traffic signalled junctions are reaching the end of their serviceable life and are experiencing an increasing number of signal failures. This is resulting in less predictable journey times and increasing reactive maintenance costs. Increased proactive maintenance of these sites will reduce the numbers of failures on key strategic routes, and if undertaken with matched funding from developers or growth investment, could enable sites to be enhanced to derive greater traffic capacity within strategic corridors or urban areas.
14. Customer satisfaction with Oxfordshire County Council is comparatively poor when benchmarked against other authorities. Highways is often cited within responses to surveys as a major contributor to satisfaction levels. Significant investment within highway maintenance, in parallel with improved communications, will assist in addressing this perception and should ensure that relative customer satisfaction improves. The majority of the population live on local roads (C and U class) where condition is significantly lower than the strategic road network, meaning their daily experience and therefore satisfaction is influenced by this.
15. There is typically a direct correlation between the number of potholes identified on the highway network and the number of insurance claims that the council receives, (including personal injury claims from cyclists) and the subsequent repudiation rate. In the past 5 years, the council has received 4,700 insurance claims and has had a repudiation rate of approximately 80%. Over the same period the council has paid out £1.6m<sup>1</sup> for successful claims. An increased expenditure in preventative maintenance could therefore significantly reduce future costs and effort in insurance claims.
16. Whilst the condition of the highway network within Oxfordshire is aligned with the national average, neighbouring and nearby authorities have invested in the maintenance of their networks in recent years meaning and as a result have an A & B road network that is in better condition than Oxfordshire. These authorities are likely to be seeking to attract new businesses and investment in much the same way as Oxfordshire's growth strategy seeks to do. Research shows that the condition of the highway network influences where small and medium size businesses (SME's) choose to locate and as such an improved road condition may provide the council with a competitive advantage in realising its growth potential.

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<sup>1</sup> This includes two large personal injury claims of £425k and £325k. The time lag in claims being settled/ repudiated (normally up to 3 years, with minors having up to 21 years to make a claim) mean it is not possible to accurately put a figure on actual claims payouts by year until a considerable number of years has passed.

17. A report of research and modelling undertaken by the Transport Research Laboratory on behalf of the council (Societal and Economic Impacts of the Road Network in Oxfordshire) shows that maintaining carriageways at a steady state condition generates £5 within the local economy for every £1 invested. This considers only those benefits that can be directly predicted such as reduction in accidents, journey times, fuel costs, direct employment from construction activities etc. The actual benefits to the broader economy and potential for growth are likely to be significantly higher.
18. Highway condition plays a significant role in people's decision of transport mode, with people much less likely to choose to cycle or walk if there is a perceived risk to safety. To a lesser extent this extends to people's choice to use the bus where the ride quality experienced from poor highway condition is felt. The council seeks to encourage these forms of transport as part of its Connecting Oxfordshire Strategy (LTP4) in a bid to accommodate the increased movement of people that will result if the planned growth in the county is realised.
19. Over the last 20 years construction costs have been increasing at a rate approximately 1% above the consumer price index (source: Baxter price index) and in recent years this gap has widened and is predicted to widen further still as demand for large infrastructure projects and housing growth increases, creating greater competition for skilled workforces and greater demand for materials and specialist equipment. This suggests investing now means savings later.

### **Proposed Plan for Highway Investment**

20. It is proposed, subject to the availability of funding (see below), that up to £80m, more than current levels of capital spend, be provided over the next 5 years to redress the deterioration of the condition of highway assets.
21. To derive the maximum benefit to the entire highway network from this level of investment, the preferred funding profile for this additional investment is indicated below.

Asset	Current Projected Annual Spend (£m)	Additional Need (m)					Total
		2019/20	2020/21	2021/22	2022/23	2023/24	
Preventative Carriageway Treatments	8.4	7.0	9.0	10.0	10.0	8.0	44.0
Major Carriageway Repairs	2.5	2.0	3.0	3.0	3.0	3.0	14.0
Highway Drainage	0.9	0.5	1.0	1.0	1.0	1.0	4.5
Footways	0.7	1.0	1.0	1.0	1.0	1.0	5.0
Bridges	1.8	0.5	2.0	2.25	2.25	4.0	11.0
Traffic Signals	0.25	0	0.25	0.25	0.5	0.5	1.5
<b>Total</b>	<b>14.55</b>	<b>11</b>	<b>16.25</b>	<b>17.5</b>	<b>17.75</b>	<b>17.5</b>	<b>80</b>

22. The profile of spend between asset types would be reviewed annually to ensure that they continue to best reflect asset need (including the requirements of local roads vs the strategic network), Council priorities and deterioration profiles.

### **Revenue Implications of Highways Investment**

23. The proposal would need increased annual revenue budgets for network surveys of approximately £0.2m to ensure that the investment can be targeted at locations that derive the greatest benefit for the network. It is anticipated that this would be funded by a reduction in reactive defect budgets currently required to address potholes.
24. The proposal would need increased staffing to deliver the programme of works however any additional staff costs would be recharged to capital budgets.
25. Individual schemes will seek to maximise advantage of traffic management activity by undertaking traditional revenue activities such as sign cleaning and maintenance, road marking renewal, gully cleansing, vegetation trimming etc. at the same time where practicable to reduce the cost of those activities, and increase the noticeable impact of this investment.

### **Property Asset Management**

26. The Council has a significant property portfolio of over 1100 assets; 520 assets in the schools' estate and 615 in the corporate estate. The replacement value across the entire estate is £687m.
27. The portfolio is diverse ranging from schools, social care facilities and adult learning provision to culture, arts and heritage venues. These assets are fundamental to the Council's ability to deliver service and offers significant opportunities to support growth, investment and community development.
28. Over the last ten years the Council has reduced its asset portfolio by 100 assets and whilst this has reduced the pressure on the maintenance budget a significant backlog remains. The Council is committed to further reducing its asset base in support of the Fit for the Future Target Operating Model (see report at CAx on this agenda).
29. The Council's spend on the maintenance of its non-school estate has reduced by 21% over the last five years and has not been sufficient to maintain the portfolio. This decline in spend was compounded by the performance of Carillion, who the contracted to deliver an end to end property service, including the management and maintenance of our estate. The Council terminated its relationship with Carillion in January 2018 and commenced work to address the legacy of Carillion's poor management of the estate. Carillion went into liquidation in February 2018.
30. There are several immediate and critical legacy issues arising from both the decline in the spend on maintenance and Carillion's liquidation:

- a) The rectification of known defects with completed projects;

162 projects of the 602 projects undertaken by Carillion had known defects which were not complete when Carillion went into liquidation. These projects range in size from small kitchen completions to school extensions. Carillion's liquidation means that the Council cannot require Carillion to rectify the defects as it no longer exists, the council will have to bear the costs itself.

- b) The treatment of latent defects (defects not known at this point that could emerge over time);

There is a further liability arising from the risks/costs that might emerge from building defects that are not known about at this point but could occur in the future. These latent defects are usually covered through standard contractual arrangements, but these are not applicable in the context of Carillion's liquidation.

- c) The assessment of the estates compliance with statutory and health & safety requirements;

The Council must be confident that its estate complies with all statutory and health and safety requirements. An audit programme to assess and identify improvements to the statutory and operational compliance of the non-schools estate is due to complete at the end of October 2018. A remedial programme will then be defined and costed, for consideration in the 2019/20 Service & Resource Planning process.

- d) The condition of the estate;

The quality of information about the condition of the estate is poor and work undertaken on the condition of our estate under the contract with Carillion is unreliable. A report has been commissioned to assess the condition of our estate to enable the quantification of the repairs and maintenance backlog.

- e) The condition of the school estate;

In addition to the non-school estate, significant investment is needed in schools to address issues arising both from the legacy of Carillion and in the under-investment in schools nationally.

The increased capital funding will be used flexibly to satisfy the criteria below to provide confidence that the school estate is fit for purpose and specifically to allow the Council to deliver key projects that will either save significant costs in future, or meet demonstrable need at present e.g. Northfield School.

31. At this point in time, it is not possible to quantify the investment in the estate that will be needed to address defects, latent defects, statutory compliance and the condition of the estate. A programme of work is underway to evaluate and cost this legacy and will form part of the Service and Resource Planning Process. However, the costs are likely to be significant, between £20m and £40m over the next 5 years and will require additional capital funding.

## Financial Case

32. The current Medium Term Financial Plan (MTFP) includes taxbase<sup>2</sup> growth projections of 2% per annum, this equates to an additional 4,940 to 5,140 properties a year. The Housing and Growth Deal is expected to accelerate house building across Oxfordshire to deliver 29,455 houses by March 2023 ranging between 5,239 and 6,379 per year. This is 6,549 above original projections. This growth trajectory will see council tax revenues rise beyond that which has been included in the MTFP. Whilst the housing projections do not align exactly with the MTFP, if the accelerated housing is delivered, additional income of approximately £5.7m is expected by 2024 as shown in the following table.

Year	Taxbase per MTFP	Taxbase increase per MTFP %	Accelerated delivery per H&G Deal	Accelerated taxbase increase %	Taxbase Difference between MTFP and Deal	% difference in taxbase	Potential Additional Council Tax £000
2017/18	243,807	2.15%	-	-			
2018/19	246,841	1.24%	-	-			
2019/20	251,778	2.00%	5,239	2.12%	302	0.12%	444
2020/21	256,813	2.00%	6,169	2.45%	1,133	0.45%	1,698
2021/22	261,950	2.00%	5,954	2.32%	818	0.32%	1,249
2022/23	267,189	2.00%	6,379	2.44%	1,140	0.44%	1,776
2023/24	272,533	2.00%	5,714	2.14%	370	0.14%	587
TOTAL			29,455		3,763		5,755

33. This increase in council tax revenue could be used to fund additional borrowing for capital investment, through external borrowing (from the PWLB), from internal borrowing (see explanation below), or a combination of both. If the recommendation arising from this report is agreed, then options for borrowing will be considered as part of the Service & Resource Planning process for ultimate approval by Council in February 2019.
34. The Council currently has, and is expected to have high level of cash balances over the medium term. Cash balances arise from the level of reserves that are held and the timing differences of payments made and income received. Cash balances are currently around £400m and are invested through Treasury Management activity. Of this sum, an element will be what is considered 'core cash'. This is the minimum level that is expected to be held by the Council beyond the medium term. This 'core cash' balance can be used to fund a borrowing requirement instead of borrowing

<sup>2</sup> the number of band D equivalent properties from which council tax will be collected – also broadly equates to the number of additional houses built

externally. This is referred to as internal borrowing. An advantage of internal borrowing is that the Council does not incur the interest payment that is payable on external borrowing. The interest earned on the cash balance is foregone, however this is currently significantly less than the cost of interest payable on external borrowing. Currently an average of 1.3% is earned on cash balances compared to interest on external borrowing of 2.8%<sup>3</sup>.

35. Based on current rates, every £10m of external borrowing costs £0.5m per year to repay both capital and for interest payments; and £14.4m over a 30-year repayment period. To borrow £120m would cost £5.7m per year and £171m over a 30-year period.
36. Cash balances are forecast to remain at a high level over the medium term, and as part of the Treasury Management Strategy for 2019/20, a view will be taken on the level of 'core cash' and the options to maximise the use of cash balances held.
37. The amount of borrowing that can be taken in each year will be agreed as part of the Service & Resource Planning process each year, once the Council receives confirmation of the taxbase figure from the District Councils and the increased revenue is known. This will ensure borrowing is timed to match the increased level of revenue and will not take place if the additional revenue does not materialise, therefore minimising the risk and keeping the debt management cost at an affordable level within the MTFP.
38. It should be noted that this approach will not limit additional prudential borrowing that can be funded by other approved means.

## **Governance**

39. This investment proposal does not require or seek to establish any new forms of governance or review. While this will represent a significant increase in the totality of our capital programme, there is a clear and robust governance and service delivery model in place to allocate this funding.
40. A separate business case will need to be written for each bid to access funds from this borrowing from the service area which is seeking additional funding. Each business case will explore all other areas of funding before borrowing is committed. The business cases will in turn need approval via the standard capital governance process, as set out in the council's Financial Regulations, including scrutiny/approval at the Community Infrastructure Delivery Group, the Community Infrastructure Programme Board and Cabinet.
41. It is recognised that there is a need to develop a Performance Management Framework (PMF), to monitor and manage the delivery of this investment. The current governance arrangements will be enhanced, to include a PMF which will look at providing evidence to support the management of a successful investment, identifying, for example, key measures which will allow us to demonstrate the maximisation of benefits and the delivery of value for money.

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<sup>3</sup> Current PWLB rate for 30 year loan

## **RECOMMENDATION**

**42. The Cabinet is RECOMMENDED to:**

- (a) note the report; and**
- (b) approve the inclusion of significant investment in the Council's assets as part of the proposed Capital Programme to 2029, the funding for which will be included in the proposed Budget for 2019/20 and Medium Term Financial Plan to 2022/23 which will be considered by Cabinet in January 2019.**

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