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Briefing 15/11 March 2015

Highways funding, self-assessment and capitalisation of repairs in England

To: all highways contacts in England
For info: all other contacts

Key issues
£6bn funding package for highways authorities from 2015-21
Incentive Fund introduced to encourage up take of asset management approaches
Challenge Fund with bidding rounds for major schemes

1. Introduction

This briefing will look at recent developments in highways funding in England and how the capitalisation advice provided via CIPFA might impact budget issues.

The Department for Transport (DfT) published 'Gearing up for efficient highway delivery and funding' in January 2014 to stimulate debate and looked for views and evidence on the suggested mechanisms for the distribution of £5.8 billion funding for local highways maintenance from 2015/16 to 2020/21. The document can be read here. A series of regional meetings were held to generate further ideas and feedback from local highways authorities. The document was applicable to England (outside London) only.

Views were collected and fed into the consultation document 'Local authority highways maintenance funding: 2015/16 - 2020/21' which was issued in November 2014. A response to the Consultation on Local Highways Maintenance Block Funding2015/16 onwards was issued in December 2014 and highway maintenance funding formula allocations, 2015/16 to 2020/21 were published to individual local authorities on 23rd December 2014.

2. Funding

Details in 'Local authority highways maintenance funding: 2015/16 - 2020/21' note that the Needs element funding package will be £4.7 billion across the six year period, and excludes the funding for the Incentive element and the Challenge Fund. The total funding available over this period will amount to just under £6 billion.

The allocations for each element were as follows – roads – 75% (A, B&C and U roads allocated 25% each); bridges/structures – 14%; lighting – 2%; cycleways and footways – 9%.

However, to allow time for the Department to specify the data requirements for cycleways and footways, this letter element will be introduced from 2018/19 onwards. For years 2015/16 to 2017/18, the elements will receive the following proportions: roads – 82.42% (A, B&C and U roads allocated 27.47% each); bridges – 15.38%; lighting – 2.2%; cycleways and footways – 0.

For comparison the allocations for last year were roads - 66%), bridges/structures - 29%; lighting - 5%.

The figures for years 2018/19 are indicative, subject to a refresh of the data, a review of the bridges data in the formula and the addition of the cycleway and footway element.

The document 'Local authority highways maintenance funding: 2015/16 - 2020/21' retained the main elements from the previous consultation document.

2.1 Needs Element

The Needs element (formula) accounts for by far the largest proportion of the funding with the formula comprising of information on key highway assets types, such as road length, bridges, street lighting and footways and cycleways in a similar way to previous years' allocations. However there have been some changes such as the removal of the de-trunked road element, allocations based on the number of bridges and street lighting columns only (as opposed to their conditions), to include an allocation for cycling and walking and the removal of an allocation for traffic volumes.

2.2 Incentive Element

A new Incentive Element from 2016/17 will be allocated following the completion of a self-assessment exercise by each local highways authority. There will be 3 potential bands each authority could be allocated to - Band 1 for early stage authorities; Band 2 for mid stage authorities and; Band 3 for final stage authorities. For Band 3 authorities the formula would deliver the maximum level of funding available to the authority, whilst authorities in Band 1 in 2020/21 would receive no incentive funding at all.

The aim is to promote continual improvement in efficiency and evidencing this will be part of the self-assessment process. Banding will be based on an authority's record in pursuing efficiencies and asset management or on its public commitment to adopt these practices within an agreed period of time.

The Department is in the process of drawing up the self-assessment questionnaire and it will be sent out in the first instance as a pilot exercise. It will be used for the first time for the 2016-17 allocation.

2.3 Challenge Fund

The New Challenge Element from 15/16 will amount to £600m in total over the 5 years to 2021. The types of projects eligible include major maintenance or renewal of bridges, tunnels, retaining walls or other structures; carriageways; footways or cycleways; drainage assets or upgrades to street lighting.

An authority can bid for up to one small (£5m to £20m) and one large (£20m+) scheme per tranche and there will be 2 tranches. The bids for Tranche 1 by must be received by 9th February 2015 with the decisions being made known by late March 2015. Bids for Tranche 2 are likely to be in late 2017 for funding starting in April 2018. The bids should have a strategic and a financial case including the project costs with a local authority or private sector financial contribution expected of at least 10%.

In terms of the way forward, the cut-off date for Challenge Fund applications was 9th February 2015 with the successful schemes expected to be announced in late March 2015. New Needs formula and Challenge Fund will in place for the next financial year, 2015, with the Incentive element formula being in place by April 2016.

The Department has been working to ensure that the allocations are in place as quickly as possible and the 6 year funding until 2021 is certainly beneficial in enabling longer term planning for investment in the network.

Any under spend will be allocated in line with Needs Element.

3. Capitalisation

The funding allocation means local highways authorities are relatively well off in capital terms. However they are experiencing problems in terms of revenue funding.

The DfT document 'Gearing up for efficient highway delivery and funding' (see above) states the following -

> 1.9 Highway maintenance funding can be allocated from capital or revenue sources. Capital is primarily for structural renewal of highway assets (including roads, footways, bridges, drainage and lighting). Maintenance expenditure, principally funded by revenue, is mainly for reactive purposes and covers repair of worn or damaged roads and facilities, either short term patching or a permanent replacement. In addition to maintenance of the road surface itself, it also includes the cost of lighting, footway repair and cyclical maintenance such as cleaning activities (of assets such as the drainage system), grass cutting and vital services such as snow and ice clearance, and salt spreading.
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> 1.10 Planned, preventative maintenance, which involves resurfacing at regular intervals, is the most cost effective method of keeping the road surface in good repair. Indeed the Asphalt Industry Alliance

suggest that it is at least twenty times more expensive to patch and mend than it is to undertake long lasting repairs, with preventative treatments postponing such costly interventions and providing the option for more financially sustainable options to be planned.

1.11 The Department for Transport provides capital funding to local authorities for highways maintenance. Revenue is provided by the Department for Communities and Local Government (DCLG) through Revenue Support Grant.

A councils' capital expenditure is defined in law as expenditure which increases the value of its assets. This can be by creating , purchasing or improving assets and includes immovable assets such as roads and bridges.

CIPFA produced guidance in May 2014 which supports local highways authorities undertaking pothole work as capital expenditure. The guidance is noted at Appendix A

The guidance notes that expenditure on potholes is not initial acquisition or construction of an asset and therefore in order to ensure compliance with the Accounting Code local authorities should consider the following questions:

1. Does the expenditure add to or replace part of the asset, i.e. should it be classified as subsequent expenditure?

2. Does the expenditure extend the useful life or increase the level of performance of the asset, i.e. does it add to the future economic benefits or service potential associated with the asset?

3. Can the cost of the item be measured reliably?

It explains that if the answer is 'yes' to all these questions then expenditure on potholes should be treated as capital expenditure. It would appear acceptable to answer 'yes' to the 3 questions with only the third question needing a relevant costing procedure in place.

It goes on to say that temporary repairs will not usually extend the useful life or increase the level of performance of the carriageway and therefore are not normally regarded as capital expenditure and this is appropriate. There is a level of interpretation around the term ' temporary' with some manufacturers claiming their products provide a permanent whilst they may not live up to that description.

It is important that the option to capitalise this work is used where it can be to ensure officers have the choice to allocate the cost to the utmost benefit.

4. APSE Comment

APSE welcomed the consultation exercises and events and the Department engaged with many from the sector in a positive exercise. However, the feedback did not clearly support some of the decisions made. It is certainly the case that the approach is novel to an extent and the Department has not fully made the case for the changes that have been made.

Nonetheless APSE would encourage all involved in the delivery of these services to continue to engage both with the HMEP and other sector bodies. We have long promoted the benefits of sharing information and ideas and we will do so in future.

The creation of both the Incentive Element and Challenge Fund will result in funding going to some but not all who might potentially receive it. This introduces competition between those bidding and there may develop a scenario where some are unwilling to share the lessons which have seen them improve because they may lose out in financial terms to others who will benefit from putting those lessons into action.

Incentive Element - there are discussions to be had about how to define effective and efficient practices simply because each authority is in unique circumstances and what is good practice for one may not be for another. Equally highways authorities need to be able to access examples of work in other authorities and to keep abreast of developments in the sector. APSE has been working on the Connect and Sharer workstream of HMEP to progress this issue and it is to be hoped that resources will be allocated to ensure this continues.

The questionnaire would have to be unambiguous if it is be used as a funding tool. If it was open to challenge there would be little confidence in the process. Any extra work involved in completing a self-assessment must of course be kept to a minimum.

There is an argument to suggest that that those who are doing well should receive less than those who have yet to apply efficiencies or have an up to date asset management strategy on the basis that it is the service users who will ultimately receive a poorer service if there is less funding available. Equally those looking to establish asset management approaches having not previously done so would benefit greatly from having further resources in place whilst they are doing so.

However the Department's approach is based on them having previously encouraged highways authorities to take up such an approach. DfT now thinks it is time to incentivise all local authorities to take up asset management to ensure that the sector achieves the most it can from the allocated resources and so rewarding those authorities that have an asset management strategy and can demonstrate use of that strategy.

The intention to encourage sharing of practice amongst local highways authorities is a laudable one. There is a large amount of sharing already happening of course with APSE being at the forefront of such activity but encouraging more of it and at a national scale is to be welcomed. By making it a factor in whether authorities get there full funding allocation, the Department has raised the issue to new heights and there will be some authorities looking to evidence how they engage in ways they have not done before.

Needless to say the process cannot be allowed to develop into a beauty contest whereby the organisation which is best at blowing its own trumpet gets the most funding. All information provided in the self-assessment must be valid and the onus falls on the Department to ensure there are robust guidelines and procedures in place to make self-assessment fair and transparent.

Challenge Fund - the will be concerns about arrangements for the Challenge Fund element. The deadline for applications was 9th February 2015 and this meant that applications will have been rushed and perhaps not as well thought out as would have been the case if a longer time had been given to submit them.

There is of course a need to apply resources and time to bidding for funds. Although officers will have ideas and priorities for specific schemes if a funding stream is available, there will be few with detailed plans drawn up for schemes waiting on the shelf.

The element of competition introduced for the Challenge Fund is seen by some as leading to a portion of available funding being inaccessible and not controlled by those who should be receiving it. It should also be remembered that the most common outcome of a bidding round is that they are over-subscribed. This inevitably leads to losers as well as winners and a possible reluctance for the losers to apply a second time in case the same scenario occurs. Ultimately they may feel they are being deprived the opportunity to access a portion of the funding. DfT have to ensure support is in place for those not successful in the Challenge Fund through HMEP.

Alternatively the argument that this is a positive way forward enabling the completion of major maintenance schemes which are economically important is hard to dismiss. Funding such schemes through the normal allocation processes would be very difficult. The Department points to an ageing network as partial justification for the new funding mechanism and there will be demand for the fund to commence large scale schemes.

Capitalisation – the severe budget cuts experienced by local authorities over the past 3 years will carry on for the foreseeable future. Under such circumstances as much flexibility as possible is needed if service are to be maintained, let alone improved.

The three questions specified in the CIPFA guidance will enable funding to be capitalised if that is deemed necessary. It is important that the option to capitalise this work is used where it can be to ensure officers have the choice to allocate the cost to the utmost benefit.

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Appendix A

CIPFA The Chartered Institute of Public Finance Accountancy

Accounting treatment for Pothole expenditure

Potholes Review
Local authorities are reminded of the three key messages to come from the Highways Maintenance Efficiency Programme Potholes Review:

> **Prevention is better than cure** – intervening at the right time will reduce the amount of potholes forming and prevent bigger problems later.
> **Right first time** – do it once and get it right, rather than face continuous bills. Guidance, knowledge and workmanship are the enablers to this.
> **Clarity for the public** – local highway authorities need to communicate to the public what is being done and how it is being done.

They are also reminded of the following recommendations:

Recommendation 6 Prevention is Better than Cure
Local highway authorities should adopt the principle that 'prevention is better than cure' in determining the balance between structural, preventative and reactive maintenance activities in order to improve the resilience of the highway network and minimise the occurrence of potholes in the future.

Recommendation 10: Permanent Repairs Policy
Local highway authorities should adopt permanent repairs as the first choice. Temporary repairs should only be used where safety cannot be managed using alternative approaches and in emergency circumstances.

Routes to Capitalisation
One of the routes by which expenditure can qualify as capital expenditure is in accordance with "proper practices" as detailed in paragraphs 4.1.2.16 and 4.1.2.17 of the CIPFA/LASAAC 2014/15 Code of Practice on Local Authority Accounting in the United Kingdom (the Accounting Code) issued by CIPFA. Consistent with this is Section 4.7 of the Code of Practice on Transport Infrastructure Assets (also issued by CIPFA) the initial acquisition, construction and subsequent costs to an existing asset should be capitalised only if they result in items with physical substance and if

- it is probable that future economic benefits or service potential associated with the item will flow to the entity
- the cost of the item can be measured reliably.

Pothole Expenditure
Expenditure on potholes is not initial acquisition or construction of an asset and therefore in order to ensure compliance with paragraphs 4.1.2.16 and 4.1.2.17 of the Accounting Code local authorities should consider the following questions:

1. Does the expenditure add to or replace part of the asset, i.e. should it be classified as subsequent expenditure?
2. Does the expenditure extend the useful life or increase the level of performance of the asset, i.e. does it add to the future economic benefits or service potential associated with the asset?
3. Can the cost of the item be measured reliably?

If the answer is yes to all these questions then expenditure on potholes should be treated as capital expenditure.

Point to Note:
Temporary repairs will not usually extend the useful life or increase the level of performance of the carriageway and therefore are not normally regarded as capital expenditure.

May 2014