

HAMPSHIRE COUNTY COUNCIL

Decision Report

Decision Maker:	Executive Lead Member for Transport and Environment Strategy
Date:	3 October 2022
Title:	Hampshire Highways Service Contract - Contract Extension
Report From:	Director of Economy, Transport and Environment

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Purpose of this Report

1. The purpose of this report is to recommend that the Hampshire Highways Service Contract is extended by the maximum period available of five years, and to seek approval to extend the contract to 30 April 2029.

Recommendations

2. That the Executive Lead Member for Transport and Environment Strategy notes the contractual timescales for the Hampshire Highways Service Contract and the significant risks associated with procuring a new contract in the current financial and economic climate.
3. That the Executive Lead Member for Transport and Environment Strategy notes the opportunities proposed by Milestone Infrastructure Limited to improve the highway service for the duration of the extended contract period, and also the comments and advice provided by an external specialist to independently review the proposals, as part of the due diligence process, and provide an overview of current market conditions.
4. That the Executive Lead Member for Transport and Environment Strategy approves the development of revised performance measures to ensure the opportunities proposed by Milestone become contractual obligations and are bound into the contract documents, and that authority to agree the timescale and scope of these is delegated to the Director of Economy, Transport and Environment, in consultation with the Head of Legal Services.
5. That the Executive Lead Member for Transport and Environment Strategy approves the extension of the Hampshire Highways Service Contract for the maximum duration of five years, which will take the contract term to 30 April 2029, and delegates authority to the Director of Economy, Transport and Environment to enter into continued contractual arrangements with Milestone in consultation with the Head of Legal Services.

Executive Summary

6. This paper seeks to outline the reasons why the Hampshire Highways Service Contract (HHSC) should be extended to its maximum 12-year duration to 30 April 2029.
7. The HHSC delivers the County Council's (statutory) highway maintenance activity across Hampshire. The contract started on 1 August 2017 with an initial term running to 2024, i.e., 7 years, with the potential to extend this by up to five additional years to 30 April 2029.
8. The construction industry and highway sector are in a state of unprecedented financial volatility due to the ongoing and residual impacts of Brexit, Covid-19 and the Ukraine crisis. If the current contract is not extended the County Council will need to procure a new contract, from scratch, at a time when the market is heavily congested, fraught with unknown risk, uncertainty, and increasing costs.
9. The success of the current contract is built on a strong collaborative relationship with the current service provider, Milestone Infrastructure Limited (Milestone). The contract remains in a stable position despite the market challenges, and Milestone is enthusiastic to extend the contract to its full duration. Milestone has submitted a document *Safer, Greener Hampshire Highways – Beyond 2024* detailing ten areas where the highways service can be developed and improved for the duration of the extended contract. The proposals offer the County Council an excellent opportunity to progress the highway service and make significant improvements in key areas such as carbon reduction and climate resilience, and they will also yield cashable savings.
10. Milestone's proposals have been independently reviewed by the international law firm Bird & Bird. Bird & Bird is considered to be a specialist in the field of highways term contract procurement and has worked closely with a number of other County Councils. The report from Bird & Bird confirms that there are clear advantages to the County Council in extending its contract and the risks and costs of re-procurement could be very significant in the current market environment, which is not showing any signs of abating at present. Bird & Bird has reviewed the ten areas proposed by Milestone as part of the extension agreement and has recommended that these are bound into the contract, forming a contractual obligation on Milestone to deliver them.

Contextual information

11. The Hampshire Highways Service Contract (HHSC) delivers all of the County Council's highway maintenance activities. The contract scope is broad and also allows discretion for capital improvement projects to be included. The contract was initially awarded to Skanska Construction UK Ltd and started on 1 August 2017, with an initial term to 30 April 2024, extendable up to 2029. The HHSC has already delivered more than £280million of highway services and projects in four and a half years, averaging an annual spend of more than £62million. In May 2021 Skanska Construction UK Ltd, sold its Infrastructure Services business, which contained its portfolio of highway maintenance contracts to M Group Services and the HHSC was subsequently novated to a newly created business, Milestone Infrastructure Limited.

12. The HHSC has developed and grown since it started and its success is largely due to the strong collaborative relationship between the two organisations, and the wider supply chain. The relationship has been a key factor in maintaining the highway maintenance service in a stable position during what has arguably become the most unstable and unpredictable period for the construction industry and highway sectors in recent memory. Three recent reports to the Executive Member; *Hampshire Highways – Service Update*, July 2021, *Hampshire Highways – Highway Network Recovery Strategy*, March 2022 and *The Impact of Inflationary Pressures on the Delivery of the Highway Maintenance Service*, May 2022, have outlined the pressures and challenges facing the highways service, which include an estimated highway maintenance backlog of £377million due to underfunding in highway maintenance from central Government. Covid-19 and Brexit have also provided their own inflationary and operational pressures, and these have been compounded further by the war in Ukraine leading to unprecedented levels of inflation and increased costs.
13. The initial term for the contract is due to end in April 2024 and this can be extended by up to five additional years to 2029, subject to negotiations between the two organisations. It was originally intended to enter into negotiations during the financial year 2021/22. However, the transfer of the contract from Skanska Construction UK Ltd. to Milestone delayed these negotiations and a decision was taken to wait until the contract had been novated and established for a suitable period of time.
14. Not extending the contract will mean that the County Council will need to start the process of procuring a new term highways maintenance contract immediately, and in the current financial climate this presents layers of complexity and significant risk. The construction industry is in an unpredictable state, and it is not expected to stabilise for several years. It is understood that a number of other highway authorities are looking to extend their current contractual arrangements with their respective service providers, hoping to steer through this current period of uncertainty. Milestone has a large portfolio of public sector highway maintenance contracts and three of these have recently been extended to secure a stable position.
15. The procurement of term highway maintenance contracts has been a selective market for bidders for a number of years. The number of strategic suppliers in the market has reduced over time due to mergers/takeovers, insolvency or from a change in strategic business direction. Tendering for contracts can be expensive for suppliers and it is widely known that contractors will meticulously target the individual contracts they choose to tender for, and these decisions are based on various factors including the perception of the client relationship in the current contract, the contract model, and the apportionment of risk. The current market conditions have significantly increased this level of sensitivity and bidders are even more selective.
16. The Future Highways Research Group (FHRG) has estimated that 26 local authorities are looking to procure new term highways contracts over the next four and a half years which means it will be a heavily congested period for both local authorities and suppliers. If the HHSC is not extended the County Council would be looking to procure a new contract at the least favourable time, and it is unlikely that a best-value solution would be secured. Ultimately this could leave

the County Council in a situation where only a very small number of bidders show an interest in bidding, and any perceived risks will be covered by significantly higher costs than are currently being encountered. When the current HHSC contract was procured, only 3 bidders entered the tendering stage in 2016, which was in a period that was far more settled than the current market. The approval of a five-year extension should enable the County Council to re-procure its next contract in a calmer, less competitive and volatile period.

17. Extending the contract by five years would provide the necessary time for the County Council to fully explore the most suitable contract model options for Hampshire for 2029 onwards. It is critical for the sustainability of the future highway service that the next contract builds on the current HHSC and is inviting to the market, and provides flexibility and opportunities for innovative development, particularly around areas such as digital technology, resilience to climate change, carbon reduction and social value.
18. When procuring new term highway contracts there is inevitably an impact on the delivery of the highways service. If the current service provider is excluded from the procurement process for a new contract at any point, it is not uncommon to see a drop in the quality of service delivery as the incumbent focuses its attention on demobilising and withdrawing at the end of the current contract. Similarly, when a new service provider is introduced, it takes time for it to mobilise the necessary people, systems and processes, and this can have a detrimental effect on the delivery of the highways service until normal operations are in place. The detrimental effects are not solely due to the new service provider's situation. Introducing a new contract and supplier will also have an impact on the County Council's staff resources, where staff will need to be taken away from their normal roles to oversee the procurement and develop the new contract. Therefore, whenever the decision is made to start the procurement process for a new contract it is likely there will be an element of disruption to service delivery for both the outgoing and incoming suppliers and County Council staff. Extending the contract will therefore postpone this highly likely disruption to the service to a period of greater stability.
19. Milestone is enthusiastic to continue working in Hampshire and extending the contract for the full five-year duration. Senior representatives from both organisations have held meetings since November 2021 to discuss and negotiate options and opportunities to extend the contract with a combined aim to improve and develop the service provision.
20. The culmination of those discussions is Milestone's formal proposal to the County Council outlined in the document "*Safer, Greener Hampshire Highways - Beyond 2024*" which details Milestone's plans for developing and improving the highways service in Hampshire over the five-year period, 2024-2029. The document is included within Appendix A of this report. Note that this is a restricted document due to its commercial sensitivity.
21. The document outlines the successes of the contract to date, including quantitative data of the services delivered, and highlights high levels of performance, including service delivery during extreme weather situations such as the cold snap between February and March 2018, and Storms Dudley, Eunice and Franklin. Milestone has also continued to deliver across all frontline

services through unprecedented difficult periods such as the Covid pandemic, and more recently the global impacts of the Ukraine crises.

22. The report details the opportunities available to the County Council by extending the contract for the full five-year duration, and these are covered by the following ten areas.
 - a) A continuously improving frontline highway maintenance service, where contract performance efficiencies are driven through the smarter use of data and jointly agreed performance indicators, resulting in a better customer/resident experience.
 - b) Sustained carbon reduction in all areas.
 - c) Supporting community initiatives, such as the parish lengthsman service.
 - d) Continued investment in the development and expansion of the Micheldever Highway Materials Recycling Facility.
 - e) Developing and implementing low carbon technical solutions, e.g., greater use of recycled products, low heat asphalts etc.
 - f) Delivering innovative and cost-effective solutions for gully waste recycling.
 - g) Increasing local drainage cleansing resources with Hampshire-specific machines in order to improve service resilience.
 - h) £5million of cashable savings and efficiencies between 2023/24 and 2029.
 - i) Providing up to £212million of social value over the full life of the contract to 2029.
 - j) Supporting the County Council in the delivery of the Highway Network Recovery Strategy.
23. The ten areas proposed by Milestone provide an excellent opportunity to enhance the highways service throughout the 5-year extension period. These include improvements to service delivery, support for local communities, innovation, and significant measures to reduce carbon emissions and improve resilience against the effects of climate change. To maximise the full benefit of these proposals it will be necessary to commit to the full five-year extension of the contract. However, a shorter duration will not provide sufficient time to deliver all the proposals, or the necessary financial payback period for Milestone.
24. There are no material or substantial changes required to the core contract terms for Milestone to provide these opportunities to Hampshire.
25. The international law firm Bird & Bird, which is a renowned specialist in highway contract procurement, was asked to independently review the proposal submitted by Milestone and to determine whether there are sound commercial and legal justifications for extending the HHSC in the current environment. Bird & Bird was selected for this commission due to its involvement with the procurement of highway maintenance services for other large county councils. Through these commissions Bird & Bird has an excellent understanding of client requirements and contract models and has recently engaged with all the main service providers in the highways sector. Bird and Bird is therefore perceived to have the most relevant and latest market intelligence for the purposes of this exercise.

26. The Bird & Bird report is included within Appendix B of this report. This is restricted for reasons of legal privilege and commercial confidentiality.
27. The report provides an overview of the following areas:
- a) Cost of procurement exercise.
 - b) Price volatility.
 - c) Bidder market.
 - d) Relationship with Milestone.
 - e) Consistency for staff and stakeholders.
 - f) Commercial benefits in the Milestone proposals.
 - g) Review of Milestone proposals.
28. Bird & Bird has recommended that the ten opportunity areas identified are bound into the contract, where this is practicable, to provide an obligation on Milestone to deliver them. This will also include the development of updated performance measures to monitor progress of delivery. It is proposed that the County Council's Highway Contract Management Team works collaboratively with Milestone to develop a series of appropriate and relevant measures for inclusion within the contract and that these are approved by the Director of Economy, Transport and Environment under delegated authority, in consultation with the Head of Legal Services.

Finance

29. The typical annual spend to date through the highways contract has been more than £60million. This is made up of locally sourced capital and revenue funding, Department for Transport (DfT) formula grants, DfT one-off grants and other external funding sources such as Section 106 developer funding. The level of spend varies each year as it is dependent on budget provision, but if the funding levels remain consistent over the 5-year extension period the total spend could potentially exceed £300million.
30. The Cabinet Report (19 July 2022) *Developing a Medium Term Financial Strategy* provides an overview of the inflationary pressures facing the construction industry and highways sector. This report outlines the instability and rising costs that are directly affecting delivery of construction related services and echoes the narrative provided in the Bird & Bird report.
31. Extending the highways contract now is considered to be financially prudent in order to minimise future financial and commercial risk on the authority during a period of significant uncertainty. The strong relationship with Milestone should also ensure there is sufficient flexibility in place should the scope of delivered services need to be reviewed as part the medium term financial strategy.

Performance

32. Since the start of the HHSC in 2017, Skanska/Milestone's performance has been good and has continued to improve over time, as expected for long term contracts of this nature. Since the start of the contract, operational productivity has increased and there has been a reduction in the operational workstack,

remedial works and third-party claims. These improvements have been made despite the external pressures and challenges caused by Brexit, Covid-19 and extreme weather events such as Storm Franklin, which have all had an adverse effect on normal operational delivery lasting many months. The contractor's performance must also be seen in the context of the sale of the Highways Maintenance business by Skanska to Milestone, and the challenges for Hampshire Highways overall, of managing a declining network with significantly constrained budgets.

33. Ongoing contractor performance or contract compliance is primarily managed via the contract's established governance structure. The drive for continuous improvement is already embedded across the Hampshire Highways relationship and both organisations work collaboratively to seek and implement changes to continuously improve service delivery.
34. The proposal from Milestone identifies ten areas for further development and improvement during the extension period. These measures will be formally bound into the contract with a jointly agreed set of new smart performance measures in place to monitor the quality and quantum of service delivery. No material or substantial changes will be required to the core contract terms to deliver these additional commitments.

Consultation and Equalities

35. Due to the nature of the approval sought for this report, limited consultation has been undertaken.
36. The decision sought in this report will not reduce the scope of the service provided or have any negative 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 a contract extension that will provide service improvements and it is not anticipated that these proposals will have a direct impact on people with protected characteristics. Rather, they are intended to improve service delivery to all highway users and help maintain and/or improve highway safety.

Climate Change Impact Assessments

37. 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 Adaption

38. The proposals submitted by Milestone for the contract extension will help to reduce the highway network's vulnerability to climate change impacts by increasing frontline resources and enabling a more responsive service.

Carbon Mitigation

39. The proposals include a commitment by Milestone to reduce its carbon emissions by 60% by 2030. The proposals will also lead to carbon reductions in planned maintenance activity through the use of warm asphalts and also expanding the scope of materials produced at the Micheldever Recycling Facility. Enhanced gully waste facilities will also see a higher proportion of waste material being recycled.
40. Data driven innovations will also create improvements to the scheduling and delivery of reactive repairs, improving efficiency and reducing disruption and diversions for the travelling public.

Conclusions

41. This report has outlined the various complexities surrounding the current market environment and the significant risks the County Council could be potentially exposed to if the contract is not extended and a new procurement exercise started.
42. Given the pressures and challenges facing the construction industry and highways sector, the HHSC contract is in a stable position due to the proactive collaborative relationship between Hampshire County Council and Milestone. Milestone is keen to extend this relationship and contract for the full term and the proposals submitted offer the County Council an excellent opportunity to develop and enhance the highways service particularly in areas such as carbon reduction, resilience to climate change, and supporting local communities, as well as providing £5million in cashable savings and £212million of social value.
43. The proposals submitted have been independently assessed and confirm that there are clear advantages to the County Council in extending the current arrangement. To re-procure a new contract in the current environment would be very risky and likely to cost significantly more.
44. Offering Milestone a shorter contract extension period remains an option. However, this would not deliver to the County Council the full range of opportunities, benefits, and value offered in Milestone's proposal.
45. The full five-year extension is anticipated to provide the County Council with sufficient time to fully investigate and prepare the next term highways contract, ready for a period of more stability and where there will be fewer highway contract retenders coinciding. The benefits will not only remain for the duration of the contract but will also create the foundation for what may follow in 2029.

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>
The Impact of Inflationary Pressures on the Delivery of the Highways Maintenance Service	12 May 2022
Hampshire Highways – Highway Network Recovery Strategy	10 March 2022
Hampshire Highways – Service Update	29 July 2021

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 will not reduce the scope of the service provided or have any negative 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 a contract extension that will provide service improvements and it is not anticipated that these proposals will have a direct impact on people with protected characteristics. Rather, they are intended to improve service delivery to all highway users and help maintain and/or improve highway safety.