



# Highways Term Maintenance Contract – Proposed Extension to Support Future Highways Model

<b>Responsible Officer:</b>	Mark Barrow, Executive Director Place	
email:	<a href="mailto:mark.barrow@shropshire.gov.uk">mark.barrow@shropshire.gov.uk</a>	
<b>Cabinet Member (Portfolio Holder):</b>	Dan Morris	

## 1. Synopsis

The report recommends a one-year extension of the Highways Term Maintenance Contract with Kier Transportation, highlighting significant service improvements and cost efficiencies. The extension will ensure service continuity and allow time to develop a future operating model

## 2. Executive Summary

- 2.1. The Highways and Environment Term Services Contract (TMC18) (“HETSC”) was awarded to Kier Transportation (the Contractor) in 2017 and commenced service delivery on 1<sup>st</sup> April 2018.
- 2.2. The initial Service Period is 7 years; accordingly, the contract will end on 31<sup>st</sup> March 2025.
- 2.3. The conditions of contract allow the Council to offer a maximum of three extensions to the Service Period, each of a one-year duration. The Council’s offer of an extension requires the Contractor’s acceptance to become effective.
- 2.4. Council Officers and contractor representatives have been working together to discuss the basis for extending the contract. Both parties have proposed amendments to the current contract.

- 2.5. Significant change and service transformation have occurred across the highway service following a difficult start to the Kier Contract 2018. The contract and its management and delivery has evolved and now focuses on key areas of strength. The “mixed economy model” is now embedded, significantly benefiting Shropshire and our residents. Shropshire Council now has far greater control and influence over services, with Kier focused on areas of strength and value for money.
- 2.6. As a result of the value the contract brings, it is recommended that a single-year extension to the Service Period be agreed upon, which will include certain amendments to the current agreement that will ensure that the contract aligns with the objectives of the Council and supports the plan and vision for the future service. The proposed extension period will ensure service continuity and give the Council sufficient time to shape and develop options for an optimal future operating model that aligns with the Council's vision. This acknowledges the current financial uncertainties within the Council and nationally.
- 2.7. This report sets out the proposed amendments to the contract terms and seeks approval to implement them via a Deed of Variation to the contract.

### 3. Recommendations

#### That Cabinet:

- 3.1. Approve the recommended amendments to the conditions of the contract and the commercial arrangements as set out in Section 7.5 of this report.
- 3.2. Authorise the implementation of the amendments via a deed of variation to the current contract between the Council and the Contractor for a period of 12 months from 1<sup>st</sup> April 2025.
- 3.3. Give delegated authority for the Executive Director of Place to explore and agree further contract amendments, in consultation with the Portfolio Holder for Highways and Transport.

## Report

### 4. Risk Assessment and Opportunities Appraisal

- 4.1 [Financial Risk] Should the recommendations not be approved; the Council will not have a contract or a full suite of alternatives in place to deliver vital services across the highway network. This would leave the council at risk and may well lead to higher cost of highways services and materials from April 2025. Additionally, the cost of procurement will need to commence immediately, estimated at a minimum of £300,000. Therefore mitigation to preserve the current cost structure and avoid reputational risk and the cost of procurement is to undertake the extension.

- 4.2 [Community, CYP and Adults Risks] The Term Maintenance Contract directly impacts the quality of highway assets affecting a positive quality of life for all road users. There are no specific identified risks for protected residents. All statutory requirements and appropriate considerations have been made.
- 4.3 [Human Rights and Equalities] The highways service transformation, of which the contract extension forms a part, seeks to strengthen our community's voice in the delivery of a highways service and the local assets which matter to them. The TMC extension has no impact on human rights or equalities.
- 4.4 [Opportunity Appraisal] The Term Maintenance Contract Extension will form part of how the service continues to develop in 2025. This report details how the “mixed Economy Model” has already and will create more opportunities to establish local supply chain links and support local economic development and retain the Shropshire Pound in our community. In addition the trials with Town and Parish Councils will continue to be developed to understand the potential for some activities being delivered at a local level.

## 5. Financial Implications

- 5.1. Shropshire Council is currently managing an unprecedented financial position as budgeted for within the Medium Term Financial Strategy approved by Council on 29 February 2024 and detailed in our monitoring position presented to Cabinet on a monthly basis. This demonstrates that significant management action is required over the remainder of the financial year to ensure the Council's financial survival. While all Cabinet Reports provide the financial implications of decisions being taken, this may change as officers review the overall financial situation and make decisions aligned to financial survivability. Where non-essential spend is identified within the Council, this will be reduced. This may involve
- scaling down initiatives,
  - changing the scope,
  - delaying implementation, or
  - extending delivery timescales.
- 5.2 The financial implications of the proposed recommendations are an increase in fixed overhead payments of £375,897.45 (see Table 1)
- 5.3 There are opportunities to reduce the increase by up to £161,908.26 (see Table 2) which Council Officers will continue to explore with the Contractor.
- 5.4 The available incentive payments will be reduced by £100,000.00
- 5.5 Therefore, the net increase in costs could be £113,989.19
- 5.6 Any net increase in overhead payments to the Contractor will be offset by a corresponding reduction in the value of the work ordered through the contract, resulting in no overall budget change.

## 6. Climate Change Appraisal

6.1 There are no climate change implications that arise as a result of this report.

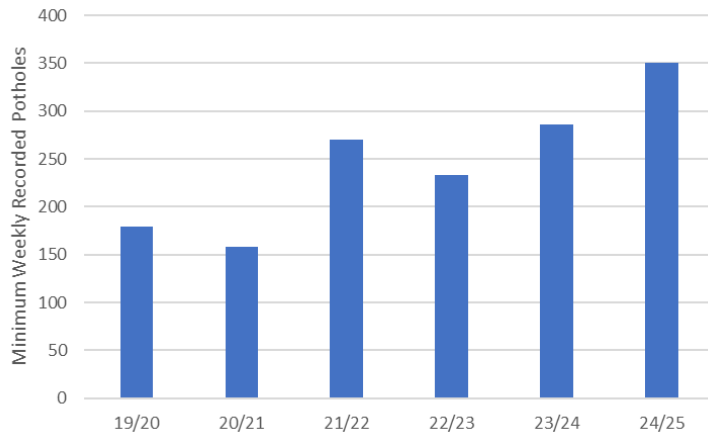
## 7. Background

### **Kier Contract**

- 7.1. The highway service is an essential council service that ensures the safe and effective movement of people and goods across the county. Local highways are a vital part of the infrastructure that enables road users to access essential services, places of employment, education, and leisure. It is, therefore, essential that resources are used effectively to achieve optimal outcomes.
- 7.2. The highway team's work is one of the most visible elements of council activity. As such, stakeholder satisfaction with the highway service often aligns with perceptions of the council as a whole.
- 7.3. Nationally, highway authorities are managing a deteriorating asset, with the cost of the national backlog now estimated to be £10.4 billion. The most recent State of the Asset Report for Shropshire estimates the annual gap in funding in Shropshire to be £14m across all highway assets. The diminishing levels of real-term financing for highways over many years have seen an increase in potholes and increased the demands on all highway services and continue to stretch the limited resources available for maintenance. Therefore, it is often difficult to disaggregate between a failing asset and a failing service or contract.
- 7.4. The service journey has involved moving towards data-led decisions and evaluation. This has played a pivotal role in explaining the challenges faced and how much is being delivered against a complex funding backdrop. The "mixed economy model" has protected the authority from the worst impact of the funding deficit by delivering reactive services differently and efficiently.
- 7.5. Pothole repairs are the most visible element of the service and often define public perception of the service. In 2023 we completed 41,629 repairs, 50% of which were completed in 5 days. This is a 46% increase from the previous year (2022) and was done at no additional cost, due to service efficiencies and the "mixed economy" operating model. The average defect cost today on our network is 66% lower than it was in 2021.

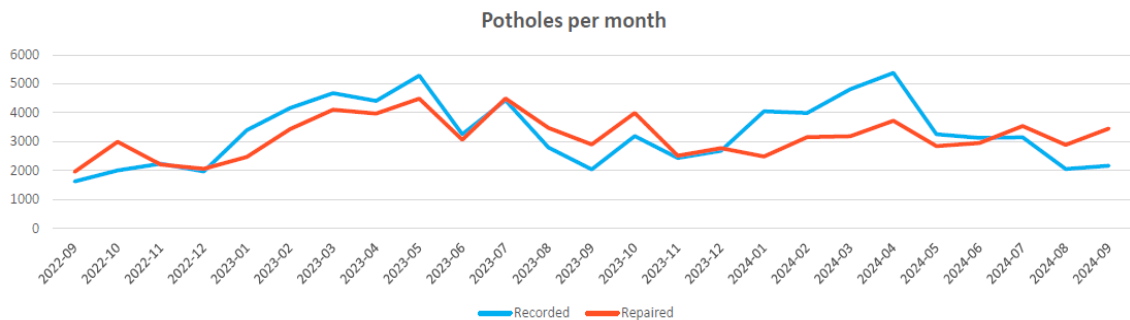
### **Demand pressures**

- 7.6. Figure 1 shows the upward trend in recorded potholes on the network and the demand pressures the service has to manage. The first six months of this year saw a sharp rise in defects due to the exceptionally wet winter, which had a detrimental impact on the network condition.



**Figure 1** – Average weekly potholes recorded

7.7. Figure 2 highlights the gap between the demand and resources and the pressure associated with the winter. The number of potholes and other carriageway defects outpaced the resources that could be deployed on the network in the first six months of the calendar year. This is a significant frustration for the service and it wasn't until May that the balance was resourced the defect number started to reduce. The highway service like all other council departments has to operate with the available budgets, so scaling up to meet the demand wasn't an available option.



**Figure 2** – Potholes recorded and repaired per month

7.8. The changes and improvements to the service were set out in detail at the previous Place Overview Scrutiny Committee, with reports explaining the service transition and how the Kier contract has been changed to re-profile it to support the council's needs.

7.9. Key Statistics

- This financial year has seen an increase in productive output on repairs of 46% (50% of which were carried out within five days) with no budget increase
- The average cost to the council of repairing a pothole has fallen by 66% in the past four years and is now below the national average.
- The percentage of the right first-time, permanent repairs, is now at 96%. This is the highest level ever as a unitary council.
- Improvements in public satisfaction recorded in NHT Survey Report

- One of the most recent service changes has seen responsibility for defect repairs on A&B roads come back under Shropshire Council's full council control. This is the area that presents the greater insurance risk. Since the 1<sup>st</sup> of April 2024, there has been a 42% reduction in defect numbers on the A&B road classifications.

- 7.10. Shropshire Council recognised that the Kier Contract, although often blamed for service frustrations, was not the root cause of the issue. The fundamental re-think of how the service functions, led to a new dawn and pivot towards service expectations and outcomes that are best met, managed and delivered locally, recognising and understanding the local needs. The authors and influencers of the contract, written in 2017 which Kier won, placed insufficient priority on local service delivery, which is the area that most influences public perception. What we have done since then is work collaboratively with Kier on the area where they are strong and add value and deliver value-for-money solutions.
- 7.11. The adaptation of the Kier contract and the “mixed economy” service delivery model and certainly, the feedback from key stakeholders helped shape this decision. What has emerged is a new ‘hybrid model’ which is seeing a more thoughtful and improved service being born and the benefits are emerging. Councils have often gone from one end of the spectrum to the other in search of a service frustration cure. A council with everything ‘in-house’ who experience costly, inefficient services that are difficult to manage will embrace the private sector in search of efficiency and commercial confidence. An Authority that experiences difficulties with an external provider, will routinely look at “bringing it back in the house”. This cycle has been replaced with the balance required for success. A ‘hybrid model’ that offers local delivery and services in control of the authority, but has a larger partner to deliver at the other end of the spectrum provides the blend needed to provide a value-for-money service.
- 7.12. This model has received industry recognition for being at the leading edge of national best practice, with Shropshire winning both “Team of the Year” and also the “Collaborate Partnership Award” at the Department for Transport Special Recognition awards for the in October this year.

## **Insurance Claims**

- 7.13. This remains a legacy issue in relation to the Kier contract and the way in which the contract was envisaged to work. This has meant that insurance liabilities, for injury or damage to third party's properties do not get passed to Kier (Red claims). This remains a complex issue with the contract in its current form.
- 7.14. The contract is an NEC3 contract and is an ‘output’ specification, so the Contractor must provide what the Council orders. The council only has a certain amount of budget available, and this has been coming under significant pressure due to the failure demand associated with under-investment in the network over an extended period. It became apparent that the Council had insufficient budget to fund the number of gangs that would be required to keep pace with the number of defects. This became most evident during the post-winter periods when defect numbers rose sharply, and at some points, the council would have needed to fund 50 reactive gangs to keep pace with the numbers entering the system. This created defects backlogs in the system, without the ability to fund the resources to meet demand or drive down the backlog. This meant that moving the liability for out-of-date repairs to Kier became unworkable.

- 7.15. The above was exacerbated during winter periods, as winter maintenance and flood responses would pull on the same gangs who were scheduled to fix pot-holes during the day. These gangs were undertaking gritting overnight and therefore had significantly reduced productivity for pothole repair. The winter has historically been the most challenging period in terms of defects increasing.
- 7.16. This was one of the drivers towards the mixed economy model. We have now developed our own direct labour capability which is significantly reducing the risk profile and will be formalised as part of the next phase of transformation. Shropshire Council now has far greater control of resources and how these are deployed.
- 7.17. While the issue regarding insurance claims remains outstanding, the service has significantly reduced the exposure to risk as a result of the mixed economy model. The continued evolution of services, Kier's re-focus, and negotiations on an extension have enabled Shropshire to take back more responsibility for reactive repairs, have more influence over these services, and target resources towards reducing risk.
- 7.18. The area of greatest risk is the A&B road network. Since the start of the financial year, the number of defects has been reduced by 46%.
- 7.19. The service has continued to develop and strengthen the “green” claims process to recover the damage caused to the asset from third parties, reducing the impact on council budgets for their repair. Recovery has increased each year, exceeding its income target in each of the last financial years. This should see the Council recover £800k this year, which is delivered via a process that did not exist at the start of the Kier contract.

### **Governance and Contract Management**

- 7.20. As stated, the Kier contract is now focused on the strengths and value for money that Kier brings to Shropshire.
- 7.21. To reflect this, a suite of Key Performance Indicators is integrated into the contract with Kier. These have a threshold of stretch targets that have been set and are used to measure performance. If they fall short of expected levels, mechanisms are in place to allow the council to take action, including the ability for the council to terminate the contract if performance is consistently below expectations.
- 7.22. The list of KPIs and Kier's current performance against them is shown below;

April 24 - Present (This financial year)			
KPI	Description	Target Performance Level	Current KPI Score
KPI 1a	Reactive & Routine Highway and Environmental Maintenance tasks completed in time. Reactive Highways Works	98.0%	100.0%
KPI 1b	Reactive & Routine Highway and Environmental Maintenance tasks completed in time. Street Lighting	98.0%	100.0%
KPI 1c	Reactive & Routine Highway and Environmental Maintenance tasks completed in time. Emergency Response	98.0%	96.7%
KPI 2	Reactive, Routine Highway and Environmental Maintenance tasks to required quality	98.0%	100.0%
KPI 3	Highway Project and scheme works completed on time and without defects	98.0%	100.0%
KPI 4	Up to date financial management information is provided on time and +/-10% of final cost	98.0%	100.0%
KPI 5	Provision of all forward works plans received on time and to correct quality	98.0%	100.0%
KPI 6	Monthly Performance Figures provided on time without errors	100.0%	100.0%
KPI 7	Applications for payment submitted on time correctly without errors. (5%)	95.0%	99.7%
KPI 8	Customers satisfied with the performance of Kier and its supply chain	80.0%	100.0%
KPI 9	Winter Maintenance - service completed on time	98.0%	N/A

7.23. All work carried out by Kier is recorded on the Council's Confirm system. This enables before and after photographs of work carried out to be available for analysis. This significantly reduces the need for staff to travel to the site to check on works increases the sample size used to undertake quality checks, ensures that the council is receiving the service that it has asked for, and provides greater protection to the council when managing claims.

7.24. An internal audit was carried out on the Kier contract earlier this year. This saw the number of issues identified as significant fall from 14 to 5 (64% reduction).

### Proposed 1-year Extension

7.25. As set out earlier in the report, the Kier contract is now fundamentally delivering differently, with a sole focus only on value for money and service areas that the contract and Kier deliver well for Shropshire.

7.26. Kier delivers a wide range of services to Shropshire Council, which include, but are not restricted to, the following:

- Highway maintenance
- Street Lighting
- Winter Maintenance
- Street cleansing
- Bridge maintenance
- Grounds maintenance
- Highway Capital projects



- 7.27. The transformation of the service has involved removing service areas and spending from the contract, to align with the budgets but also to allow a “mixed economy” to grow and develop and service delivery evolved. This has seen a significant reduction in spend with Kier. This has seen more work carried out by smaller locally based contractors.
- 7.28. Spending with Kier is forecast to be 50% less in 2024/25 than it was in 2023/24. However, the rates that are being utilised are highly competitive and this is delivered the type of work that Shropshire-based contractors would either be unable to undertake or would be unable to compete with the commercial rates Kier can offer, as a result of national arrangements with big supply chain partners. The work Kier is delivering plays a huge part in our asset management plan and investment strategy. The surface dressing programme is a good example and involves a programme this year valued at £3.3m. This per square metre is the most cost-effective intervention we have to protect the network, as it weather-proofs the surface and covers significant areas, keeping them free from potholes.
- 7.29. The resources that form part of Kier's workforce also provide significant resources for winter maintenance service and emergency calls, which is critical to the county's winter resilience arrangements. This provides the county with resilience as it allows the service to draw on resources already employed and provides overall best value and means the service can bend and flex as and when required. This includes the winter maintenance period but also storm and flooding events.

### **Amendments to the Contract Proposed by the Council**

7.29 The conditions of the contract for the HETSC include Clause ZM14.1 which states:

ZM14 Right to Provide the Service

ZM14.1 Except as provided for in this contract, the Employer does not contract with Others to provide part of the service.”

7.30 This clause restricts the ability of the Council to enter into contracts with other providers for services which are within the scope of the HETSC. This conflicts with the Council's mixed economy approach to service delivery which has been successfully implemented in recent years. The Council has therefore proposed the removal of Clause ZM14 to bring the contract in line with current working arrangements and provide clarity for both parties.

7.31 By a Deed of Variation previously executed by the Council and the Contractor, a performance management framework and incentive schedule were introduced to the HETSC. This enables the Contractor to earn up to £300,000 per annum for meeting or exceeding all performance measures. As a result of current and potential changes to the scope and value of the HETSC, the Council proposed to reduce the maximum amount of the incentive from £300,000 to £200,000 for the 2024/2025 Financial Year (the final year of the initial Service Period) and for it to be removed in its entirety for the 2025/2026 Financial Year (the one-year extension to the Service Period).

7.32 Under the HETSC, the Council pays the Contractor lump sum payments (Prices) for the provision of fixed overhead resources that are not directly linked to the contract turnover and are therefore not recovered by the measured works instructed by the Council. These Prices are:

1. The Fixed Contract Overhead – this primarily consists of payments for the Contractor’s staff required to manage the contract.
2. Servicing of Accommodation – this includes payments for maintenance and operation of each of the Council-owned offices and depots, utility costs, business rates and provision of ICT systems.

7.33 Prices for these items were submitted with the original tender and have been adjusted in accordance with inflation indices since that time.

7.34 The Contractor has stated that these Prices do not cover the actual costs incurred in providing the overheads and as a result, it loses money on these items. The Contractor has stated that this difference between the costs and the Prices can be attributed to a number of factors including:

1. Real inflation outstripping the inflation indices
2. Changes in staff requirements as a result of changes to the nature and scope of the work instructed by the Council
3. Increases in utility costs, mainly increased electricity consumption for charging the Council’s electric vehicle fleet.

7.35 As stated, the contract turnover has reduced considerably. In addition, there is uncertainty over the future contract turnover due to budget pressure and the development of a “mixed economy” (primarily due to likely budget reductions). There is a significant risk that the Contractor will not recover sufficient margin from the measured work under the contract to offset losses sustained on the overheads.

7.36 Consequently, discussions have taken place in relation to reviewing the Fixed Overheads and Servicing of Accommodation as part of the agreement for the Service Period extension to ensure that they are commercially sustainable and mitigate the risk of turnover fluctuations.

7.37 Council Officers and contractor representatives have worked together to review and “right size” the Contractor’s staffing structure and other overhead components. This has helped reduce costs, and where appropriate, the parties have sought to reduce staffing numbers by amalgamating roles, sharing roles with other contracts, and not filling vacancies if staff leave. Nevertheless, certain cost increases have been identified.

7.38 As a result of this exercise, increases in overhead payments have been identified as follows:

Item	Current Payment	Proposed Payment	Increase
Fixed Contract Overhead	£2,643,304.99	£2,863,554.33	£220,249.34
Servicing of Accommodation	£783,916.15	£939,564.27	£155,648.12

Total			£375,897.45
-------	--	--	-------------

**Table 1**

7.39 There is further scope to reduce the quantum of the additional payments as follows, and work is ongoing by the Council and the Contractor to address each item.

Item	Notes	Amount
Design Services	Attribute costs to each scheme rather than central overheads	£53,872.68
Store Person	Rationalise the number of store persons required (currently being reviewed)	£57,732.40
Utility and other costs	The Council is to pay utility and other costs directly, thereby removing the Contractor fee element	£50,303.18
Total		£161,908.26

**Table 2**

## 8. Conclusions

- 8.1 The initial Service Period of the HETSC comes to a natural end on 31<sup>st</sup> March 2025.
- 8.2 To ensure continuity of service beyond that date, the Council must either extend the HETSC or implement alternative delivery arrangements.
- 8.3 Implementing an alternative delivery model in the current climate would not support the organisation's interests due to the uncertain financial situation and the recent change of central government. This would increase the risk of developing a sub-optimal model and require at least 18 months of development and implementation.
- 8.4 Therefore, it is recommended that the HETSC be extended for one year until 31 March 2026.
- 8.5 In order to implement a one-year extension with the agreement of the Contractor, it is proposed that the following amendments to the contract be made:
1. Removal of Clause ZM14.1 to enable the Council to continue the mixed economy approach to service delivery.
  2. A reduction in the maximum incentive payment for the 2024/2025 Financial Year of £100,000.
  3. Adjustments to the Fixed Overhead and Servicing of Accommodation payments in line with the parameters in Section 5 of this report.

**List of Background Papers (This MUST be completed for all reports, but does not include items containing exempt or confidential information)**

None

**Local Member:** All

**Appendices** [Please list the titles of Appendices]

---