Advice to Department for Transport on an Interim Settlement for National Highways for 2025 - 2026

Advice Note 3: Capital specification

20 February 2025

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1. Introduction

Purpose

1.1 The second road period (RP2) is due to end in March 2025. National Highways' funding for the period April 2025 to March 2026 will be determined through an Interim Settlement. This will enable the company to continue undertaking its statutory functions to operate, maintain and enhance the strategic road network (SRN) before the start of the third road period (RP3) in April 2026.

1.2 The Department for Transport (DfT) asked Office of Rail and Road (ORR) to assist in the development of the Interim Settlement through the provision of advice in the following areas:

- the affordability and deliverability of National Highways' emerging plans for 2025-26;
- the performance specification; and
- the capital specification.

1.3 This note sets out our advice on the capital specification for 2025-26.

Background

1.4 The statutory direction and guidance to National Highways for 2025-26 issued by the DfT will include an Investment Plan. This will set out the government's requirements that National Highways must deliver in the interim period through its capital programmes, including enhancements, renewals, and Designated Funds. National Highways is expected to respond to the Investment Plan through an interim period Delivery Plan which they must publish and deliver. For this advice we have considered that together, these form the 'capital specification' for the interim period.

1.5 This report focuses on whether the emerging requirements included in the Investment Plan are challenging and deliverable for the available funding. Our advice is based on information provided at a point in time. It draws on the draft Interim Settlement document of 3 February 2025, in addition to plans set out by National Highways in its business plan of 22 November 2024.

1.6 Proposals for the interim period capital specification have been subject of discussions between DfT, National Highways and ORR throughout the process of developing the settlement. This advice does not repeat the entirety of the views we have put forward during that process and discussions between parties are continuing.

1.7 We recognise that there are challenges when setting an annual settlement as funding is required for the progression of design and preparatory work that will realise outputs and outcomes in subsequent years. Whilst requirements need to be clear and unambiguous, we need to be cautious not to allow plans to become overly specific and stifle National Highways' ability to apply its knowledge to deliver the government's objectives in the way it sees fit. Overall, we believe the Investment Plan strikes an appropriate balance between providing clearly specified requirements and avoiding being overly prescriptive or rigid.

1.8 In places we have outlined where we would expect additional information to be required, either in National Highways' interim period Delivery Plan or reported during the year for assurance purposes, to ensure we can robustly hold the company to account for delivering those plans. This includes areas where we believe it is prudent for the company to report progress against funding lines where there is no clear output within the year proportional to the investment assigned. This will help to provide confidence that the company is not only delivering the interim period requirements but also preparing effectively for RP3. We will work with National Highways on the level and format of detail required to facilitate reporting arrangements and, where required, set out in guidelines to the company once the interim period Delivery Plan is finalised.

2. Assessment

2.1 This section considers whether the emerging investment plan requirements and outputs represent a challenging and deliverable proposition for the available funding.

Enhancements

Major projects

2.2 The draft Interim Settlement requires that National Highways will deliver and progress schemes that were commitments in the second road investment strategy. National Highways' business plan for the 2025-26 is aligned to this requirement.

2.3 The draft Interim Settlement includes the following commitments:

- Start of Works (SoW) – M3 Junction 9, A47 Thickthorn Junction
- Open for Traffic (OfT) – A63 Castle Street, M25 Junction 28

2.4 We understand that milestones for all schemes currently in development are subject to the outcomes of the government's spending review and the RIS3 development process.

2.5 The Interim Settlement will include funding for the development of a range of projects that are due to commence in RP3. This includes development phase, land purchase and early enabling costs for Lower Thames Crossing in line with the expected delivery programme.

2.6 In our advice on the affordability and deliverability of emerging plans for 2025-26 issued to DfT in December 2024, we concluded that the overall level of capital funding was likely to be adequate to deliver the interim period requirements based on the programme we reviewed. This assessment was for all schemes and was not limited to the schemes with SoW or OfT milestones in the interim period. However, careful management of the portfolio will be needed to manage the uncertainties relating to the enhancement portfolio. We also recommended that National Highways, alongside government, continue to explore options to restrict discretionary spending on projects, such as advanced works, on projects that are subject to greater uncertainty.

Interim period Delivery Plan and in-year reporting

2.7 We currently hold the company to account for meeting quarterly milestone commitments. For the projects listed in paragraph 2.3, in its interim period Delivery Plan, we expect that National Highways should specify the quarter in which the milestone will be achieved to ensure consistency in the interim period. Any changes to these milestones during the year will be subject to the existing change control process.

2.8 As a consequence of the single-year settlement, the majority of schemes in the enhancement portfolio will not achieve a SoW or OfT milestone during the interim period. Nevertheless, it is essential that we can effectively hold National Highways to account for progressing these schemes in an efficient manner and in accordance with their agreed programmes. This will provide assurance that the company is ready to deliver RIS3.

2.9 To this end, in its regular quarterly reports, and once there is sufficient certainty following the Spending Review, we recommend that National Highways continues to include updates on its progress towards achieving SoW and OfT milestones, even if these milestones fall within RP3. However, we acknowledge that RP3 milestones may change during the RIS3 development processes and could require adjustments throughout the year.

2.10 For schemes that will remain in the development phase during 2025-26, and again, once there is sufficient certainty following the Spending Review, we also recommend that National Highways sets out development objectives for each scheme. This may be specified in terms of Project Control Framework (PCF) stage gates or phases. It should report its progress in meeting these objectives in its quarterly reports. This will help to support our advice on plans for RIS3 and ensure we can hold National Highways to account for undertaking the preparations necessary to ensure projects are delivered in a transparent and efficient manner in RP3. As for SoW and OfT milestones, we recognise that development objectives are subject to policy decisions and other external factors and may change.

Small schemes programme

2.11 In preparation for RIS3, DfT has asked National Highways to develop and deliver a programme of smaller schemes. The programme would consist primarily of projects costing less that £25m with the objective of reducing congestion, improving safety, improving provision for active travel, or contributing to the levelling-up agenda.

2.12 The draft Investment Plan includes a commitment to develop a prioritised list of small schemes and a programme for delivery during RP3. In its interim period plans, National Highways has allocated funding to undertake the prioritisation exercise and has indicated it will progress the design of around 30 schemes.

Interim period Delivery Plan and in-year reporting

2.13 In addition to identifying priority interventions, we advise that the design and development of schemes is advanced during 2025-26. This will enable National Highways to commence construction on priority schemes early in RP3 and begin realising the benefits of the programme as soon as possible.

2.14 In its interim period Delivery Plan, we recommend that National Highways provides more detail on the level of design development and appraisal it will achieve, at least for a sub-set of projects.

Future RIS and scheme development

2.15 The Interim Settlement allocates funding for activities to develop projects and programmes for future road periods.

Interim period Delivery Plan and in-year reporting

2.16 Precise details of these projects and programmes have yet to be determined. We propose that National Highways' interim period Delivery Plan, or through other reporting, should provide further details of specific schemes under development and the stage of development that will be achieved by the end of the year. This could be provided at a programmatic, rather than project-specific, level. This will help in supporting our advice on RIS3 and will provide a clear basis for which we can hold National Highways to account, providing confidence on the company's readiness to deliver during RP3.

Designated Funds

2.17 The Interim Settlement will set out how DfT expects National Highways to allocate its funding across the various Designated Funds and the types of activities to be undertaken within each fund. Additionally, the Investment Plan is likely to include more specific commitments relating to two key sub-programmes:

(a) local safety interventions for major A-roads to directly address safety concerns, linked to the International Road Assessment Programme (iRAP) star rating; and

(b) remediation of its highest risk water outfalls and soakaways to improve environmental outcomes.

Interim period Delivery Plan and in-year reporting

2.18 To date, National Highways has provided limited information on how it plans to use the Designated Funds. These funds are intended to support smaller scale projects that respond to opportunities and challenges arising during a road period, which limits the ability to specify deliverables in advance. Within the context of a single-year settlement, we reasonable to expect that the company would already have identified and planned projects for delivery in 2025-26 to ensure efficient use of these funds. Additional information is required within National Highways plans or through reporting to allow us to effectively monitor the company’s performance in 2025-26.

2.19 A proportion of the funding allocated to Designated Funds will be used for development activities aimed at preparing projects and programmes for delivery in RP3. Similar to the small schemes fund, we would expect National Highways to specify key deliverables resulting from development spending, enabling us to hold the company accountable for effective use of these funds.

Renewals

Strategic renewals projects

2.20 ‘Strategic renewals projects’ are renewals projects that are exceptional in terms of their cost, complexity, road user disruption or other factors. A notable feature of National Highways’ emerging RIS3 plans is the increasing number of high-cost renewals projects it expects to deliver.

2.21 As set out by DfT in its draft investment plan, given their cost and impact, there is a need to strengthen monitoring and reporting arrangements for these projects. DfT, National Highways and ORR have been working collectively to consider how these arrangements can be established and trialled in the interim period. During the year, we will work together to assess the effectiveness of these measures, capture lessons learned, and refine them as needed for RP3.

Defining strategic renewals

2.22 We have considered various approaches defining what constitutes a strategic renewal project and discussed these with DfT and National Highways. We proposed the following two options that strike a balance between effective scrutiny and minimising unnecessary regulatory burden.

- Option 1: This option employs a simple cost threshold on the basis that the costliest renewals projects are also those most likely to be complex and disruptive. We would propose that all schemes with a forecast outturn cost of £30m or more are included. Based on National Highways interim draft Strategic Business Plan (SBP) for RIS3 (which was based on the period 2025-26 to 2029-30), 22 projects of this size will be progressed in the next five years. We consider this would represent a manageable number of projects to report on and monitor, particularly given than the number of major enhancement projects is likely to reduce during RP3.

- Option 2: Under this option, all schemes with a forecast outturn cost of £50m or more would be automatically included (ten projects based on the interim draft SBP). Schemes with a forecast cost of between £30m and £50m (i.e. the remaining 12) would be assessed for inclusion on a case-by-case basis using the following criteria: construction duration; complexity and delivery risk; anticipated disruption and stakeholder impact. Schemes will be selected based on professional judgement using evidence provided by National Highways. The final list of schemes would be agreed by DfT, ORR and National Highways.

2.23 Option 1 is our preferred option. However, following discussions with DfT and National Highways, all parties have agreed to progress with Option 2 for the interim period. The definition of strategic renewals projects will be reviewed based on the experience of 2025-26 and revised for RP3 if necessary.

2.24 While it may be less relevant for 2025-26, a governance process is needed to add (or remove) projects to the strategic renewals list mid-period if costs, risks, or complexity increase (or decrease). This process should maintain accountability and transparency while allowing the company to remain agile in delivery.

Interim period Delivery Plan and in-year reporting

2.25 The finalised list of strategic renewals projects being progressed during the interim period will be set out in National Highways' Delivery Plan. Relatively few projects are expected to start construction or reach completion during 2025-26. Therefore, to provide confidence that National Highways is ready to deliver projects in RP3, we recommend the interim period Delivery Plan includes the following two key milestones where they occur in the interim year: (1) construction commencement; and (2) completion, and, in addition, reports progress through key design stages for all other projects throughout the year. Appropriate definitions of each milestone need to be agreed that drive the right behaviours and align with user and stakeholder expectations, and existing arrangements within National Highways.

2.26 An appropriate description and outline scope of each scheme needs to be provided. We recommend that cost estimates for each scheme should also be provided and updated on a quarterly basis, in line with our current reporting on major schemes. We recognise, however, that milestones and cost estimates may be adjusted during the RIS3 development process.

Renewals output commitments

2.27 We are encouraged that DfT intends to specify renewals outputs for six asset types within its Investment Plan: flexible (asphalt) pavements, rigid (concrete) pavements, structures, drainage, roadside technology and vehicle restraint systems (VRS).

2.28 In our advice on the affordability and deliverability of National Highway's emerging plans for 2025-26 (submitted to us on 22 November 2024) we concluded that, whilst the company's renewals plans appeared deliverable, there was insufficient evidence provided to confirm that the proposed output volumes were both challenging and efficient. This was primarily because current planned volumes were lower than previously indicated in the company's interim draft SBP for RIS3.

2.29 Since then, National Highways has revised its proposals in some areas and provided further information on its plans to support their efficiency. Whilst this addresses our concerns in several areas, we will continue working closely with the company as it finalises its interim period Delivery Plan to evidence that its renewals plans are both robust and efficient in all areas. We are satisfied that the company is working towards this goal and we have agreed an 'action plan' for the work it will undertake before finalising the Delivery Plan.

2.30 There are three main strands of activity under the company's action plan: checking and challenging plans where output volumes remain lower than comparative benchmarks; providing further evidence to support its plans; and, agreeing how the company will report on its performance during 2025-26. The latter is particularly important for a single-year settlement because one of the reasons planned outputs appear to be relatively low in 2025-26 is because the company will be undertaking activities (such as design and development) for which outputs will not be realised until RP3.

2.31 The interim period Delivery Plan will not be complete until after the Interim Settlement is finalised. Therefore, output commitments for some asset types may need to be adjusted, via change control, from the level indicated in the Interim Settlement. National Highways will have to be able to demonstrate that it is maintaining efficiency levels during 2025-26. The company has not shared detailed plans for how it intends to do so but we understand that it intends to put more weight on unit cost analysis. This would be appropriate for a situation, as we are likely to be in for the interim period, where efficiency cannot be judged solely based on the delivery of agreed volumes for post-efficient funding levels.

2.32 Table 2.1 summarises the draft output commitments for 2025-26 as currently proposed by National Highways. The remainder of this section considers whether they have been set at a challenging and deliverable level.

Table 2.1 Draft renewals output commitments as proposed by National Highways

Asset type	Planned expenditure (£million)	National Highways' proposed output commitment
Flexible (asphalt) pavements	324	1,315 lane km (+/- 2%)
Rigid (concrete) pavements	75	22 lane km of reconstructive renewals
Structures	339	76 significant structures schemes progressed
Drainage	85	41 flooding hotspots mitigated (+/-5%)
Roadside technology	119	CCTV: 270 to 500 assets Signs: 168 to 313 assets Signals: 199 to 396 assets
Vehicle restraint systems	74	261 km of barrier renewed (+/-5%)

Flexible pavements

2.33 National Highways has proposed delivering 1,315 lane kilometres of asphalt pavement renewals during 2025-26, with a budget of £320m. The company proposes a 2% range around the commitment. We are unclear as to the basis for this range and we are concerned that the effect including this tolerance would be to reduce the effective target by 2% with no clear rationale for doing so. We appreciate that renewals plans will be subject to a degree of change during the year. As per our holding to account policy, where there are good reasons to explain why outputs are lower in practice than originally anticipated, we take this into account in our monitoring.

2.34 At 1,315 lane kilometres, National Highways' proposal represents a reduction in volumes compared to the 1,650 lane kilometres delivered annually on average in RP2. Based on the unit rates underpinning the company's RIS3 interim draft SBP, and assuming all other factors remain constant, the proposed investment level implies that up to 1,900 lane kilometres could be delivered.

2.35 We recognise that the cost of pavement renewals schemes can vary widely depending on the characteristics of the scheme in question. For example, deeper pavement renewals (at 100mm to 180mm) are significantly more expensive than shallow renewals (up to 50mm). An increase in the average pavement depth could result in higher overall unit costs. Therefore, there may be factors, based on good asset management, that explain a reduction in planned volumes in any given year.

2.36 As part of its action plan for finalising interim period renewals plans, National Highways has committed to undertaking a review of its pavement plans both to challenge current estimates and to provide evidence to support the efficiency of its plans. We will work closely with the company during this process.

2.37 If DfT adopts National Highways' current proposal of 1,315 lane kilometres, we expect this will need to be revised upwards (or costs revised downwards) once plans are finalised.

Rigid (concrete) pavements

2.38 As outlined in our advice on the interim draft SBP, the concrete roads programme remains in flux due to higher-than-expected costs and delays experienced during RP2. Consequently, National Highways will make less progress than anticipated towards its stated goal as set out in its RIS2 draft SBP to replace the legacy concrete pavement assets with modern designs by the end of RIS6.

2.39 In 2025-26, National Highways' is proposing to limit concrete pavement renewals to the completion of the overrunning M27 Junction 5 to 7 concrete overlay scheme, delivering 22 lane kilometres of concrete reconstruction at an anticipated cost of £46 million. This is in line with our current expectations of this scheme and, as a complex, high-cost renewal, we will track its progress via the new strategic renewals reporting and monitoring arrangements already described.

2.40 It is not feasible from a practical or financial perspective to replace all concrete roads in a short period of time. Consequently, National Highways undertakes life extension works, such as pothole and joint repairs, while prioritising reconstructive renewals (replacing concrete road surfaces with asphalt) for routes most in need of treatment. During RP2, the company delivered a combination of reconstructive renewals and life extension works. The interim draft SBP outlines plans to continue this approach, combining reconstructive renewals with life extension works. However, National Highways has indicated that no life extension renewals will be delivered in 2025-26.

2.41 This leaves £29 million, of which £6.5 million will be spent by regional teams on the design of upcoming schemes, while £22.5 million will be allocated to the national concrete roads programme for activities such as optioneering, condition surveys, and innovation work. By comparison, during RP2, the concrete roads programme expects to spend approximately £31 million on development activities over the entire five-year period.

2.42 Managing and replacing life-expired concrete roads is a relatively new area, necessitating research and development activities. National Highways suggests that the higher level of spending is due to the way it has profiled its plans, with development activity ‘front loaded’ in 2025-26. Nevertheless, the proportion of funding allocated to these activities in 2025-26 (39%) is relatively large. Therefore, it is important we hold the company to account for completing these activities, as well as delivering renewals outputs.

2.43 In its action plan National Highways has committed to providing further details of planned development activities, their anticipated benefits, and how they will contribute to the efficient delivery of the concrete roads programme. We will work with the company to agree how progress will be reported and monitored during the interim period.

Roadside technology

2.44 National Highways proposes renewing between 637 and 1,209 assets, across CCTV, signs, and signals asset sub-types. Such a wide range is unsuitable for a firm commitment and would make it difficult to determine if they have successfully delivered within the allocated funds. The company has indicated that it will provide more accurate forecasts before finalising its plans and has provided some initial proposals in this regard.

2.45 The level of outputs planned for 2025-26 is reduced from the level set out in the interim draft SBP. In large part, this is due to the intended profile of activity, with more design, development and procurement activity taking place in 2025-26 for outputs that will ultimately be delivered in 2026-27. This profile was not reflected in the plans set out in the interim draft SBP which were less detailed. As for rigid pavements, National Highways has agreed to provide details of development activities in its interim period Delivery Plan and report on their progress during the year.

2.46 Before finalising its plans, National Highways should provide further details of its plans for roadside technology renewals including evidence to support its cost estimates and we are satisfied the company is working towards this aim. This is particularly important as there is significant public scrutiny around the capability of National Highways ability to maintain and renew its technology assets.

Drainage

2.47 Under the plans submitted in November 2024, National Highways indicated that it would renew drainage assets between 31 and 51 flooding hotspots in 2025-26. Subsequently it has provided a more accurate estimate of 44 flooding hotspots. We are satisfied that this aligns with the approach set out in the interim draft SBP and recommend DfT adopts this target in the investment plan.

2.48 National Highways has proposed a tolerance of 5% either side of its forecast. As for the ranges proposed for other asset types, whilst we recognise that plans may change during the year, we don’t see the need for introducing a range this year and the basis for its scale is unclear.

2.49 As National Highways points out, the number of flooding hotspots renewed is a relatively crude measure of performance and efficiency. Therefore, during the remainder of the RIS3 development process, we will work with the company to develop improved measures of success.

Vehicle Restraint Systems (VRS)

2.50 As with drainage, National Highways has provided updated forecasts for VRS since its November 2024 submission. The company is proposing a target of 261 kilometres of steel barrier renewal (+/-5%). As for other asset types, the proposed range appears to be arbitrary and risks introducing ambiguity.

2.51 Under the current plan, the implied unit cost of barrier renewals would be lower than that used in National Highways’ interim draft SBP by around 14%.

2.52 The cost of barrier renewals depends largely on the chosen solution, including the required containment level and whether the project involves repairing an existing barrier or fully replacing a life-expired one. The activity that the company undertakes has implications on both the risk it is mitigating on the network and the overall whole life cost. It may be acceptable for the company to deliver a lower total length of barrier if it demonstrates a higher proportion of full replacements.

Therefore, we recommend that the company reports its outputs in a way that separately specifies the lengths of barriers to be repaired and fully replaced.

Structures

2.53 The structures renewal programme consists of four sub-programmes: significant structures, predictive renewals, priority risk structures, and the Avonmouth Viaduct, which is treated as a standalone scheme due to its size and complexity.

2.54 In our advice on the interim draft SBP, we questioned National Highways' decision to remove funding from its preventative renewals programme, which could reduce the whole-life cost of maintaining some ageing structures. There appear to be no plans to continue this programme in 2025-26, and no evidence has been provided to justify this decision.

2.55 The significant structures programme accounts for the majority of structures renewals costs. In 2025-26, National Highways is proposing to progress 76 significant structures projects, 49 of which are already in progress and 27 will commence during the year. We recommend DfT adopts this target in its investment plans.

2.56 To date, National Highways has defined the outputs of this programme in terms of number of significant structures schemes progressed. Under this approach, if a scheme progresses more slowly than anticipated, the company could still claim an output simply on the basis that some development or construction activity has taken place. We consider this to be ambiguous and provides a poor basis for assessing performance and efficiency. Therefore, we recommend the interim period Delivery Plan sets out commitments relating to the number of significant structures projects that will be fully completed, and the number of projects progressing to specified design, development or construction milestones.

Other asset types

2.57 The six asset classes for which output commitments will be defined in the Investment Plan account for 83% of planned renewals spending. While other asset types make up only 17%, their allocation of £200 million still represents a significant capital investment. National Highways' emerging RIS3 plans includes proposals to spend more on each of these asset classes in RP3 than in RP2 to address a specifically identified objective. Key examples are improving the condition of footpaths and cycleways (classed as ancillary assets) or enhancing safety or biodiversity via soft estate renewals.

2.58 To ensure that National Highways can provide assurance that these funds are being appropriately allocated to mitigate the risks they have identified and deliver the performance objectives for which funding has been provided, we believe it is important that the company sets out more detailed plans and associated outputs in its interim period Delivery Plan or through in year reporting. This is a consistent approach with previous Delivery Plans that the company has agreed and published. In turn it will also allow the company to be effectively held to account and provide transparency around potential risks for the renewals programme in RP3.

Other capital investments

2.59 National Highways has allocated capital funds for other activities that fall outside the definitions of enhancements, Designated Funds and renewals. This includes operations (£184m) operational technology (£46m) and digital and corporate services (£359m). The company often depends on these activities to meet broader commitments, yet their impact is not always reflected in their key performance indicators (KPIs). In many cases – such as for corporate carbon initiatives, or estates upgrades – it should be possible to clearly define measurable outputs from these investments. Whilst not covered by the Interim Settlement document itself, we recommend that National Highways specifies the key outputs from these activities in its interim period Delivery Plan, or within its in-year reporting, that will be delivered. This will ensure that these funds are not diverted to cover overspend in other areas without appropriate transparency and reasoning.

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