Advice to Department for Transport on interim settlement arrangements for National Highways for 2025 - 2026. Advice Note 1: Affordability and deliverability

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12 December 2024

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Executive summary

Background

The second road period (RP2) is due to end on 31 March 2025. National Highways' funding for the period April 2025 to March 2026 will be determined through an interim settlement. The Department for Transport (DfT) has asked ORR to review the company's preliminary plans for 2025-26 and provide advice to inform the final settlement.

This paper sets out ORR's advice on the affordability and deliverability of National Highways' plans. It follows from a review, undertaken by ORR during Spring 2024, of the company's interim draft Strategic Business Plan (SBP) for the period 2025-26 to 2029-30.

DfT has asked ORR to consider whether National Highways has robust plans to deliver proposed renewals outputs, and that planned activities and funding levels are aligned in respect of enhancements, Designated Funds and other programmes. DfT has also asked ORR to review the company's overall approach to inflation.

All parties have been working at pace to respond to the decision to defer the start of road period 3 (RP3) and recent changes to available funding for 2025-26. The note sets out the findings of a high-level review carried out over a three-week period between 22 November and 12 December 2024. Plans for 2025-26 are still evolving and this review is based on preliminary information provided by National Highways during the review period. We will work closely with DfT and the company to offer ongoing advice and guidance as the interim settlement is finalised.

National Highways' financial proposals

DfT has asked National Highways to plan on the basis of a funding envelope of £4,765m for 2025-26, with capital expenditure limited to £3,310m and revenue expenditure limited to £1,455m. This compares with forecast outturn spending in 2024-25 of £5,109m, of which £3,670m is capital and £1,439m is revenue.

As shown in Table 1.1, National Highways' preliminary plans for 2025-26 amount to £4,934m and therefore exceed the funding envelope by £169m. The funding gap for capital is £115m and for revenue is £54m. Both capital and revenue funding are at a lower level than the company envisaged in its interim draft SBP produced in February 2024.

As capital and revenue funding are subject to individual constraints, we have considered the affordability and deliverability of plans for each in turn.

Table 1.1 National Highways' financial proposals (£ million, nominal)

	Forecast spend in 2024-25	Interim draft SBP 2025-26	Current proposals for 2025-26
Operating and maintaining the network	Comparable breakdown not available. See section 1.0 for further details.	1,415	1,439
Capital renewals		1,249	1,282
Existing enhancements commitments		1,479	1,175
New enhancements commitments		8	-
Designated funds		117	94
Future RIS and scheme development		35	27
Central risk reserve		93	50
Digital and corporate services		554	595
Protocols		88	84
Lower Thames Crossing		349	250
Other 'unfunded' costs		-	10
Overprogramming adjustment (Lower Thames Crossing and A66 Northern TransPennine)		-	-71
Total (Revenue)	*1,439*	1,567	*1,509*
Total (Capital)	*3,670*	3,821	*3,425*
Total	**5,109**	**5,388**	**4,934**
		Available funding for 2025-26	**4,765 (1,455 Revenue and 3,310 Capital)**
		Implied funding gap for 2025-26	**169 (54 Revenue and 115 Capital)**

Capital expenditure

Renewals

Key message

National Highways' renewals plans for 2025-26 are likely to be deliverable; however, we have not seen evidence demonstrating that planned volumes represent an efficient level of delivery.

In its interim draft SBP, National Highways provided some evidence of growing renewals requirements and the need to invest more in renewals. The company plans to allocate £1,282 million for renewals in 2025-26. This represents an increase in expenditure on 2024-25 but, when compared on a like-for-like basis, is slightly less than originally proposed in the company's interim draft SBP. The company appears to have been unable to scale up renewals activities in 2025-26 at the pace necessary to align with its previously planned trajectory. For certain asset types, such as roadside technology and concrete pavements, the company is proposing to allocate a portion of 2025-26 funding to uncompleted RP2 projects. This represents a missed opportunity as it ultimately means addressing renewals requirements less quickly than previously proposed.

Although we have not had the opportunity to review National Highways' asset-level plans in detail, the company's allocation of spending across different asset types appears broadly appropriate. In our advice on the interim draft SBP, we raised concerns about the company's decision to reduce expenditure on pavement renewals and its readiness to efficiently scale up investment in roadside technology renewals at the pace it had proposed. It had been unable to evidence this ramp-up was deliverable or explain what outcomes it would achieve for users. The company has addressed these issues in its plans for 2025-26 by increasing planned investment in pavement and proposing a more modest increase in spending on roadside technology to align to a more appropriate delivery expectation.

Based on the overall funding that National Highways has allocated for renewals, and the balance of spending by asset type, we conclude that the company's plans are likely to be deliverable. However, given the funding allocated, we have yet to see evidence that the *volumes* of renewals proposed have been set at a sufficiently challenging and efficient level. Where data has been provided, compared with its interim draft SBP, the company has reduced the level of outputs it proposes to deliver in 2025-26. All things being equal, this suggests plans are less efficient than those put forward in the interim draft SBP.

Before finalising its plans for 2025-26, the company should review the proposed output levels and provide evidence demonstrating that the plans are at least as efficient as delivery costs in 2024-25 would suggest.

Designated Funds and other capital

Key message

There remains a lack of detail as to the specific outputs the company will deliver across Designated Funds and other capital projects. Once the deliverability of these is fully tested, this may result in modest reductions in planned capital spending.

In its plans for 2025-26, National Highways has brought the proposed new National Programmes, and the small schemes fund under the umbrella of Designated Funds. In line with our advice in its interim draft SBP, the company has removed the previously proposed operational technology National Programme. This is now included within its renewals funding. The resulting reduction in cost is offset by the inclusion of safety schemes originally planned for 2024-25. These safety schemes were originally intended to help the company meet its RIS2 target for reducing the number of Killed and Seriously Injured (KSI) casualties on the network.

Funding for other activities is unchanged, but National Highways has not clarified how it will distribute funding across the various priorities. The evidence it has presented does not remedy our earlier concerns about the lack of detail in these plans. The company’s proposed level of spending indicates that it will rely on an existing pipeline of capital projects already in development. The company must provide DfT with clearer information on the projects it is committed to deliver in 2025-26 and demonstrate that design and development work to prepare for RP3 is commensurate with planned spending.

National Highways has also allocated more capital funds to operations, digital technology, and corporate support. This increase is partially attributable to changes in the way spending is categorised across the various spending lines. As with Designated Funds, the company needs to provide greater clarity as to how these funds will be utilised and the specific outcomes they are expected to achieve.

For example, National Highways has decided to accelerate its programme to install LED lighting across its network, leveraging the increased capital available. Subject to reviewing these plans in more detail, this appears to be a cost-effective initiative, as LED lighting lowers energy consumption and reduces maintenance costs. However, the company has yet to address concerns about the feasibility of delivering other elements of its carbon reduction plan. It must specify which initiatives it plans to begin in 2025-26 and clarify the extent to which these initiatives could commit government to increased spending in RP3.

In our review of the interim draft SBP we raised concerns about National Highways' readiness to hit the ground running in 2025-26 in respect of Designated Funds, National Programmes and other capital initiatives. We have yet to see evidence that these concerns have been addressed. As these plans undergo further assessment this may highlight deliverability issues leading to a modest reduction in planned capital spending and therefore the capital funding gap.

Enhancements

Key message

Both project-specific risks and the pattern we have observed during RP2 suggest National Highways is likely to underspend in 2025-26 against its current projections as activities are delayed or deferred.

National Highways has been asked to continue delivering the portfolio of schemes included in its second road investment strategy (RIS2), excluding those cancelled following the Autumn 2024 Budget announcement. No new enhancement schemes have been added to the portfolio for 2025-26.

While the total cost of the portfolio has increased, the costs that National Highways expects to incur in 2025-26 have fallen by £304m (relative to the interim draft SBP) to £1,175m as enhancements projects have been deferred or delayed.

We have reviewed the affordability and deliverability of National Highways' enhancement plans based on high-level information on recent changes in scheme-level assumptions and current risks.

In our advice on the interim draft SBP, we concluded that National Highways' cost estimates for enhancement projects, over a five-year period were likely to be understated, making further cancellations or deferrals inevitable unless additional funding was provided.

However, cost escalation and delays are often interlinked. Focusing specifically on 2025-26, any emerging risks are more likely to result in a further reduction in cost in 2025-26 as the company defers activities to the third road period (RP3, 2026-2031). This conclusion is supported by both the nature of short-term risks affecting specific projects and the observed trend during RP2, where the company has consistently underspent its original annual enhancement budgets, deferring activity to later years.

Decisions to progress with several enhancement schemes currently in development are subject to a spending review that will not complete until mid-way through 2025-26. National Highways' project-level cost estimates assume timely decisions are made to progress with these schemes as currently planned. As such, there are significant risks that some projects will not progress in line with their current programmes and therefore spend will slip into RP3.

National Highways has partially addressed this issue by incorporating an 'overprogramming' adjustment of £71 million for the two largest schemes in the portfolio: the A66 Northern Trans-Pennine (A66) and the Lower Thames Crossing (LTC). Including an overprogramming adjustment acknowledges the reasonable likelihood that the actual funding required will be lower than the current cost estimates. This appears to be a prudent method for managing uncertainty in these projects. However, our preliminary assessment, based on the evidence provided to us at this time, is that even with this adjustment, an underspend on enhancements appears likely.

Recommended approach to capital funding

Key message

While we would ordinarily expect National Highways to produce a balanced plan, given current uncertainties, the funding gap could be managed by accepting a level of 'overprogramming' of the enhancement portfolio, additional to that currently proposed by National Highways. This could be reduced before the interim settlement is finalised by taking pre-emptive decisions to slow the progress of some schemes to reduce exposure to potentially abortive costs.

Given the balance of risk continues to point towards an underspend, maintaining funds in a Central Risk Reserve (CRR) – the purpose of which is to manage risks that lead to higher cost – is unlikely to be justified in the current circumstances. Setting the CRR to zero would reduce the current capital funding gap from £115m to £65m. Although the precise figures will inevitably change before plans are finalised, the remaining capital funding gap could be managed by increasing the level of 'overprogramming' by £65m from £71m to £136m. This appears manageable given the experience of RP2 and remaining risks and uncertainties about the enhancement portfolio.

Retaining a significant level of 'overprogramming' effectively accepts that some projects will not be able to progress according to currently planned timescales. Delaying projects inevitably introduces inefficiencies. While we would normally expect direct alignment between plans and funding levels, we consider this to be a reasonable approach in the context of constrained funding and current uncertainties.

The approach to managing 'overprogramming' in 2025-26 largely depends on whether capital flex arrangements – allowing National Highways to carry forward a portion of its capital funding to the next financial year – remain in place. In the absence of such arrangements, the company should proactively consider options to reallocate funding to renewals or other capital programmes during 2025-26, should a surplus arise, to ensure the effective use of public funds and its readiness for the next road period. Any reallocation of funding should be undertaken in a transparent manner.

Given uncertainties surrounding the enhancement portfolio, unless firm commitments are given, National Highways, alongside government, should explore options to restrict discretionary spending on projects that will remain in the development phase until RP3. An example is LTC, where the company, and government, must strike a careful balance between reducing delivery risks and minimising potentially abortive costs.

Revenue expenditure

Key message

It is likely to be feasible to operate and maintain the network at proposed funding levels with limited impacts for performance during 2025-26. However, this will have longer-term implications for performance and safety if funding is not increased in RP3. Closing the funding gap requires difficult choices and National Highways must demonstrate why it has ruled out alternative options before reducing spending on activities that most directly affect the performance and serviceability of the network.

As noted, at £1,455m, National Highways' revenue funding has been set at around 1% higher than forecast spending in 2024-25. Based on the evidence provided thus far, while it is feasible for the company to operate at this level of funding, it nonetheless presents a significant challenge in the context of inflation, increased wage settlements, and rising National Insurance costs. During RP2, the company has already encountered difficulties operating within budgetary allowances, primarily due to higher-than-expected inflation. Also, around 40% of the company's revenue costs relate to payments to Design, Build, Finance and Operate (DBFO) companies that are essentially outside its control and indexed to inflation.

National Highways has applied various adjustments to planned revenue expenditure, the net effect of which is a reduction in cost in 2025-26 of £58m compared with the interim draft SBP. This includes reallocation of spending, previously categorised as revenue, to capital. The company needs to further reduce cost by £54m to close the funding gap. This requires a reduction of around 6% of non-DBFO spend.

National Highways has provided a narrative summary of the changes it has made to its forecasts although we have not seen the details of all of these changes. While the company has reduced planned maintenance spending to improve affordability, we have yet to see evidence that the company has challenged its revenue costs in all areas.

As noted, National Highways has initiated an internal exercise to identify and evaluate options for reducing revenue costs in 2025-26. Since cost reduction necessitates policy decisions, it is essential that DfT is actively involved in this process. The costs, impacts, and risks associated with each option – including those not preferred by the company – should be clearly outlined. All spending should be prioritised based on achieving the best possible performance outcomes, rather than defaulting to previous years' levels, with the company required to provide evidence to support its chosen approach.

In its draft interim SBP, National Highways presented evidence justifying a planned increase in maintenance spending to address growing asset needs. However, to reduce cost, this increase has been removed. Under the company's current proposals, maintenance spending would remain flat in cash terms between 2024-25 and 2025-26. It has yet to provide evidence on how it intends to prioritise this level of funding.

Our initial view is that it is unlikely to have a significant impact on the performance and serviceability of the network during 2025-26 but will forgo the opportunity to improve maintenance performance and could have longer-term consequences if maintenance spending is not increased in the future. If further significant cuts are made to close the remaining funding gap this will introduce risks to the performance of the asset, including safety; affect the general upkeep and cleanliness of the network; and further add to the maintenance burden in RP3.

No single option is likely to generate the scale of savings required. However, National Highways must demonstrate that it has fully explored all alternative options, particularly those related to corporate services functions and associated projects, before reducing expenditure on activities that could impact the performance and safety of the network.

Inflation

National Highways has yet to share details of the inflation assumptions that underpin its estimates. Up-to-date and appropriate inflation forecasts are required to generate accurate forecasts of the scale of the funding gap.

National Highways has pointed out that a ‘flat cash’ revenue funding settlement will pose a significant challenge because it will require it to absorb increasing wages and prices. However, the company has not provided information on any of the inflation assumptions underpinning its current cost estimates. Over a one-year horizon, inflation assumptions have a relatively limited impact on overall costs. Nevertheless, up-to-date and appropriate inflation assumptions are required to generate accurate forecasts of the scale of the funding gap to inform the choices that need to be made before plans are finalised.

Overall conclusions

We have undertaken a rapid, high-level review of the developing proposals for an interim funding settlement for 2025-26 and considered whether emerging capital and revenue spending plans are affordable and deliverable within the available funding.

National Highways’ assessment of enhancements costs for 2025-26 is founded on reasonable and up-to-date assumptions. However, it is more likely that the company will underspend against its current estimates than overspend. Our current view is that the level of funding is likely to be adequate. The funding gap could be addressed by setting the Central Risk Reserve (CRR) to zero and accepting a higher degree of overprogramming of the enhancement portfolio. This would require careful management and is likely to be a reasonable and appropriate approach to the single-year settlement, given known risks and uncertainties. The level of overprogramming could be reduced before the interim settlement is finalised by taking pre-emptive decisions to slow the progress of some schemes to reduce exposure to potentially abortive costs where those schemes are subject to decisions still to be made by government.

In other areas of capital spending, National Highways should firm up its delivery plans and cost estimates and set out delivery commitments commensurate with the proposed level of funding. The company should consider how it could scale up or down these plans during 2025-26 in response to changes in available funding as the position on enhancement schemes solidifies.

Closing the funding gap will be more challenging for revenue expenditure than capital expenditure. It should be feasible for National Highways to operate and maintain the network within this funding envelope with limited implications for performance during 2025-26, provided that further significant cuts to maintenance are avoided. However, there will be implications in future road periods unless additional funding is made available early in RP3. The company must prioritise presenting these choices to DfT. It must evidence not only the impact of its preferred options but also provide evidence to support decisions to protect funding and demonstrate that its preferred strategy minimises impacts on safety and performance.

In all areas, it is imperative that National Highways clearly sets out the assumptions upon which its plans are based so they can be used to inform our understanding of the reasons for any deviation from expected performance during delivery.

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 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 affordability and deliverability of National Highways' emerging plans.

Background

1.4 DfT has asked ORR to review National Highways' emerging plans and financial proposals and provide:

(a) a high level-consideration of risk and opportunities for the choices of reduced spend; and

(b) views on the challenge and deliverability of the priorities in the interim settlement.

1.5 In particular, DfT has asked ORR to consider whether National Highways has robust plans to deliver proposed renewals outputs, and that planned activities and funding levels are aligned in 2025-26 in respect of enhancements, National Programmes, Designated Funds and Small Schemes. DfT has also asked ORR to review the company's overall approach to inflation.

1.6 This review follows the efficiency review that we undertook in Spring 2024 of National Highways' interim draft Strategic Business Plan ('interim draft SBP') for the period 2025-26 to 2029-30. We have drawn on the findings of that efficiency review, updating our advice to take account of changes to delivery plans and funding levels.

1.7 All parties have been working at pace to respond to the decision to defer the start of RP3 and recent changes to available funding for 2025-26. National Highways' plans for 2025-26 are still under development, and this high-level review is based on initial information provided by the company on and subsequent to 22 November 2024. While this process adheres to the principles of an efficiency review, it has been conducted within a much shorter timeframe and with significantly less detailed information. This has meant that we have had less detailed evidence to drawn on and limited opportunity to engage with the company's delivery teams. This report sets out our findings based on the evidence currently available.

1.8 DfT and National Highways have adopted an iterative approach to the development of plans for 2025-26. We will work closely with both parties during this process and where feasible provide ongoing advice and guidance as the interim settlement is finalised.

National Highways' financial proposals

1.9 DfT has asked National Highways to plan on the basis of a funding envelope of £4,765m for 2025-26, with capital expenditure limited to £3,310m and revenue expenditure limited to £1,455m. Both capital and revenue funding are at a lower level than the company envisaged in its interim draft SBP.

1.10 As shown in Table 1.1, National Highways' preliminary plans for 2025-26 amount to £4,935m and therefore exceeding the funding envelope by £170m. Therefore, further work is required to consider how the funding gap should be managed or closed before the settlement is finalised.

Funding gap

1.11 National Highways' current plans for *capital* spending exceed the available funding by £115m. This takes account of 'overprogramming' of the enhancement portfolio of £71m. Overprogramming is a conscious decision, taken in response to uncertainty, to allocate less funding to a project or portfolio than current cost estimates suggest may be required. Section 2 provides further consideration of the company's plans and its approach to overprogramming.

1.12 The funding gap for *revenue* spending stands at £54m. Reducing revenue expenditure presents a significant challenge for National Highways. During RP2 it has faced challenges adhering to budgetary limits primarily due to higher-than-anticipated inflation. Available funding means that revenue spending will need to remain broadly flat in cash terms between 2024-25 and 2025-26. Approximately 40% of the company's revenue costs are tied to fixed payments to Design, Build, Finance, and Operate (DBFO) companies. The funding gap of £54m equates to around 6% of revenue costs if DBFO payments are excluded.

1.13 National Highways has acknowledged that its revenue spending plans remain in development and has initiated an internal review to identify further cost saving measures. This review is not expected to conclude until early 2025. Our conclusions are based on the evidence available to us and we will endeavour to provide ongoing advice during and subsequent to the company's review if new evidence emerges. Given the importance of this process and the limited timeframe, it is essential that DfT and ORR remain actively involved throughout this process so that both organisations are aware of the available options, underpinning assumptions, and trade-offs.

Benchmarking against current spending levels and previous plans

1.14 Table 1.1 shows how National Highways' financial proposals for 2025-26 compare with those outlined in its interim draft SBP (which covered the period 2025-26 to 2029-30). All figures are presented in nominal terms and do not account for the effects of inflation. Section 2 provides further discussion of inflation assumptions.

Table 1.1 National Highways' financial proposals (£ million, nominal)

	Forecast spend in 2024-25	Interim draft SBP 2025-26	Current proposals for 2025-26
Operating and maintaining the network	Comparable breakdown not available. See section 1.0 for further details.	1,415	1,439
Capital renewals		1,249	1,282
Existing enhancements commitments		1,479	1,175
New enhancements commitments		8	-
Designated funds		117	94
Future RIS and scheme development		35	27
Central risk reserve		93	50
Digital and corporate services		554	595
Protocols		88	84
Lower Thames Crossing		349	250
Other 'unfunded' costs		-	10
Overprogramming adjustment (Lower Thames Crossing and A66 Northern TransPennine)		-	-71
Total (Revenue)	*1,439*	*1,567*	*1,509*
Total (Capital)	*3,670*	*3,821*	*3,425*
Total	**5,109**	**5,388**	**4,934**
		Available funding for 2025-26	**4,765 (1,455 Revenue and 3,310 Capital)**
		Implied funding gap for 2025-26	**169 (54 Revenue and 115 Capital)**

1.15 Overall, National Highways has reduced its cost estimates for 2025-26 by £454m (8%) as compared with its interim draft SBP. This is primarily due to lower capital costs that are in turn mostly the result of a reduction in forecast enhancement costs.

1.16 Revenue cost estimates are also lower by £58m. In several areas, National Highways has increased its revenue cost estimates but these increases are offset by reductions in two key areas. Firstly, changes in accounting treatment have led to the reclassification of certain revenue costs as capital. However, we are not privy to the specific details of these reclassifications, nor the agreements reached between the company and its auditors, and we have not conducted any evaluation of their appropriateness or validity. Secondly, National Highways has also reduced planned spend on maintenance by £38m, as compared with its interim draft SBP.

1.17 Table 1.1 also compares emerging plans for 2025-26 against forecast spending in 2024-25. Based on current plans and forecasts, capital spending would fall by £245m, although a reduction of £360m is required to deliver within available funding.

1.18 With respect to revenue, National Highways current estimates are 5% higher than forecast spending in 2024-25, but the increase would need to be limited to 1% to meet the current budget available for 2025-26.

1.19 For the purposes of planning for future road periods, National Highways categorises its costs differently to the approach it uses for ongoing financial monitoring. The company has not provided current estimates of its costs in 2024-25 using the same expenditure breakdown as its plans for 2025-26.

1.20 Table 1.2 is included to provide an indicative comparison between plans for 2025-26 and forecast costs in 2024-25 for each individual spending line. Figures for 2024-25 are based on the estimates included in National Highways' interim draft SBP, finalised in February 2024. In practice, since these forecasts were produced, budgets have been adjusted, and the company has reallocated funds across spending lines. As a result, comparisons should be interpreted with caution.

Table 1.2 Draft business plan comparison costs (£ million, nominal)

	Interim draft SBP 2024-25	Interim draft SBP 2025-26
Operating and maintaining the network	1,342	1,415
Capital renewals	1,114	1,249
Existing enhancement commitments (Scenario A)	1,971	1,479
New enhancement commitments	-	8
Designated funds and National programmes	238	117
Future RIS and scheme development	68	35
Central risk reserve	-	93
Digital and corporate services	459	554
Protocols	60	88
Lower Thames Crossing	191	349
Total (Revenue)	*1,424*	*1,567*
Total (Capital)	*4,018*	*3,821*
Total	**5,442**	**5,388**

2. Assessment

2.1 This section sets out our assessment of key areas of expenditure, along with the overarching issues of inflation, efficiency, and risk. We have not had the opportunity to review all spending lines in detail and have therefore focused on areas where National Highways' plans differ significantly from its interim draft SBP, or where we have previously identified potential issues and risks in its emerging plans.

Operations and maintenance

2.2 Table 2.1 provides a comparison of planned expenditure on operations and maintenance in 2025-26 between National Highways' interim draft SBP and its current proposals. Operations and maintenance involve both capital and revenue spending.

Table 2.1 Comparison costs (£ million, nominal)

	Interim draft SBP 2025-26	Current proposals 2025-26
DBFO (Revenue)	634	619
Maintenance (Revenue)	305	267
Operations (Revenue)	157	168
Operations (Capital)	145	184
Operational Technology (Revenue)	105	113
Operational Technology (Capital)	24	46
Network Electricity (Revenue)	45	42
Total	**1,415**	**1,439**

2.3 **DBFO payments** are predominantly fixed, with a variable component tied to factors such as inflation, traffic growth, safety performance, and lane availability. National Highways has no control over these costs. Given the revenue funding gap, it is crucial that these estimates are as accurate as possible, as they represent around 40% of total revenue funding. We understand that inflation assumptions have not yet been updated to reflect the latest forecasts from the Office of Budget Responsibility (OBR). The company must address this as a priority before proceeding with its review to identify options for closing the funding gap.

2.4 Funding allocated to **operations** has increased by £50m (17%) as compared with the interim draft SBP. Part of the increase is due to the effect of the recent pay settlement, movement of existing staff from National Highways' commercial and procurement team into the operations directorate, and re-categorisation of spending from other lines.

2.5 National Highways is also proposing to increase staffing levels in asset management functions during 2025-26 citing the need to support the rising levels of maintenance and renewals activities underpinning its RP3 plans.

2.6 In its interim draft SBP, National Highways' proposed efficiency savings in operations were predicated on maintaining current performance and delivering the planned programme of renewals, with existing staff levels. More broadly, the company stated that no further increases in staffing levels were anticipated across the organisation as a whole.

2.7 National Highways must provide detailed evidence to justify the proposed increase in staff levels, explain why its view on staffing requirements has changed, and set out whether it continues to support the efficiency claims in the interim draft SBP. This is particularly important given funding constraints in 2025-26 and the fact that the proposed increase would not only increase costs in 2025-26 but also during RP3.

2.8 National Highways has indicated that it is considering the extent to which its proposed increase can be offset through wider attrition or reallocation of staff across directorates. As it stands there is no evidence to support an increase in staffing levels at the organisational level. The company's headcount has grown during RP2, and while renewals expenditure is expected to rise in the future, spending on enhancements is anticipated to decline, resulting in an overall capital expenditure level that is comparable to or lower than the current levels.

2.9 It is not yet clear how the proposal for increased staffing levels has been incorporated into the current capital and revenue estimates for 2025-26 and therefore we cannot yet determine if an alternative approach would help reduce the finding gap. Therefore this needs to be considered alongside all other options for reducing the funding gap ahead of finalising the interim settlement.

2.10 National Highways’ operations spending plans include the cost of installing electric vehicle (EV) charge points and purchasing vehicles as part of its planned programme to convert its entire fleet of operational vehicles to EVs by 2030. During our review of the interim draft SBP, the company suggested that this programme would increase costs during RP3 by £49 million. As we set out in our advice, the company did not provide evidence demonstrating that the cost of this programme had been thoroughly challenged. DfT should require National Highways to provide such evidence before it embarks on the programme in 2025-26.

2.11 We have yet to review National Highways’ updated **digital services and operational technology** plans. The company reports that it has held planned revenue spending at its current level, suggesting higher expenditure on digital services than anticipated in the forecasts for 2024-25 provided in the interim draft SBP. It also suggests that there has been some reallocation of funds between operational and corporate technology. However, cost estimates for both operational and corporate technology have increased. To date, we have not seen evidence that the company has examined options for reducing cost in this area to close the funding gap.

2.12 As compared with the interim draft SBP, National Highways has significantly reduced planned expenditure on cyclical and reactive **maintenance** as part of its efforts to reduce revenue costs and close the funding gap. In the interim draft SBP, the company presented evidence highlighting the need to increase maintenance activities to address growing asset need. It identified a particular need to enhance proactive maintenance of ageing structures and to improve the management of the soft estate. We supported the proposed increase in maintenance spending on the basis it would improve maintenance performance, and ultimately the condition, safety and serviceability of the network.

2.13 At the level currently proposed, maintenance spending would remain broadly equivalent to its 2024-25 level in cash terms, before the effect of inflation is considered. This would hinder National Highways’ progress in delivering the improvements outlined in its interim draft SBP. Consequently, the company’s capacity to address any increase in asset deterioration would be diminished, leading to a higher number of defects on the network and longer response times for their resolution.

2.14 Our initial assessment is that the currently proposed level of maintenance spend, which is similar to the amount to be spent in 2024-25, is unlikely to have a significant impact on the performance and serviceability of the network in 2025-26. However, if maintenance spending is not increased in subsequent years, there could be more substantial long-term consequences.

2.15 As previously noted, despite the reduction in planned maintenance, a revenue funding gap of £54m remains. If further significant cuts are made to close the remaining funding gap this will introduce risks to the performance of the asset, including safety; affect the general upkeep and cleanliness of the network; and further add to the maintenance burden in RP3.

2.16 National Highways should reassess its maintenance plans as part of its broader review of options to address the revenue funding gap. Given the current level of available funding, the proposals put forward in the interim draft SBP are unlikely to be affordable. However, we have not yet seen evidence to justify why the company considers reducing maintenance spending to be a more feasible or acceptable option compared to cuts in other areas. Before reducing maintenance expenditure – that directly impacts the performance and serviceability of the network – the company must demonstrate that it has rigorously evaluated and challenged other revenue spending lines.

2.17 National Highways has reduced its **network electricity** cost forecast by £3m. We have not yet reviewed the basis for the updated forecast, although the reduction appears to be relatively minor. The company has indicated that pressure on revenue funding may prompt them to explore ways of reducing energy consumption, such as limiting the use of lighting to lower network electricity costs. This would only generate small cost savings and therefore the customer and safety impacts of any reduction in consumption would need to be examined carefully.

Renewals

2.18 National Highways plans to spend £1,282m on renewals in 2025-26. This compares with £1,249m allocated to renewals in the company's interim draft SBP. However, comparing the planned spending levels with those outlined in the interim draft SBP requires consideration of two key factors. Firstly, the company included

£59 million for an operational technology National Programme in its draft SBP. However, in practice, the National Programme would have been allocated to fund activities indistinguishable from roadside technology renewals. When this adjustment is made, the renewals costs in the interim draft SBP increase to £1,308 million. Secondly, the company's updated plans for 2025-26 include a forecast £60 million for addressing damage to the network caused by road users. These costs are separate from 'planned' renewals and were included as maintenance costs in the company's interim draft SBP. As shown in Table 2.2, when adjusted for a like-for-like comparison, planned spending on renewals is £86 million lower than originally proposed, representing a reduction of approximately 7%.

2.19 National Highways' cost estimate for addressing damage to the network is based on relatively conservative assumptions regarding the cost of repairs, and the amount that the company can recover from users responsible for the damage. In practice, the net cost may be lower than £60 million. Consequently, there may be an opportunity to reallocate this funding toward 'core' renewals activities.

2.20 Renewals projects often address more than one asset type. As a result, National Highways is currently unable to provide a breakdown of its outturn spending that corresponds with its forecasts for 2025-26 and future road periods. This limitation complicates asset-level comparisons over time and represents a key shortcoming that we expect the company to address in the future.

2.21 National Highways' asset-level plans have changed more than we would typically expect from those submitted early in 2024, both in terms of the funding allocation or the volume and type of activities the company proposes to undertake. The latest plans appear to be more closely aligned with the forward work programme of the regional delivery teams. While this approach is clearly reasonable, the extent of the changes raises concerns about the accuracy of the company's strategic renewals planning and how it relates to the reality of regional delivery needs.

2.22 We have not had the opportunity to review National Highways' asset level plans in detail, but key changes include:

(a) A 20% increased planned spend on flexible (asphalt) pavement renewals. This is partly the result of an increase in the proportion of deeper pavement renewals which incur higher costs. However, the company has told us that this is still subject to some uncertainty.

(b) A 45% reduction in planned spending on rigid (concrete) pavement renewals. Renewals works in 2025-26 will be limited to completing the overrunning M27 project that was previously due to complete in 2024-25.

(c) A 33% reduction in roadside technology renewals intended to achieve a more manageable ramp up in spending. Part of the budget for 2025-26 will be spent on the overrunning All Lane Running operational technology modernisation and refresh programme that was previously due to complete in 2024-25.

Table 2.2 Renewals costs (£ million, nominal)

	2025-26 DSBP	2025-26 Proposal
Flexible pavements	270	324
Structures	373	339
Rigid (concrete) pavements	136	75
Roadside technology (sometimes referred to as operational technology)	178 (Including the operational technology National Programme)	119
Vehicle road systems	59	74
Drainage	78	85
Geotechnical	46	34
Ancillaries	60	81
Lighting	54	40
Soft Estates	32	28
Tunnels	22	23
Damage to Network Property (DNP)	N/A	60
Total	**1,308**	**1,282**
Total (excluding Damage to Network Property)	**1,308**	**1,222**

Affordability and deliverability

2.23 During the RIS3 development process, National Highways has provided evidence of the need for a sustained increase in renewals investment. This is to meet the needs of ageing assets on the network, the challenge of climate change, and due to the proliferation of technology assets on the network. In practice, the company appears to have been unable to scale up renewals volumes at the pace necessary to align with its previously planned trajectory. As set out above, for certain asset types, the company is proposing to allocate a portion of 2025-26 funding to uncompleted RP2 projects. This represents a missed opportunity as it ultimately means addressing renewals requirements less quickly than previously proposed.

2.24 Although we have not had the opportunity to review plans in detail, National Highways' allocation of spending across different asset types appears broadly appropriate. In our advice on the interim draft SBP, we raised concerns about the company's decision to reduce expenditure on pavement renewals and its readiness to efficiently scale up investment in roadside technology renewals at the pace it had proposed. It had been unable to evidence that this ramp-up was deliverable or explain what outcomes it would achieve for users. Subject to reviewing plans in more detail, it appears these issues have been addressed for 2025-26 by increasing planned investment in pavements and proposing a more modest increase in spending on roadside technology to align to a more appropriate delivery expectation.

2.25 One of the factors underlying the increase in planned renewals spending is a proposed increase in spend on assets that have received less attention in the past such as footpaths and cycleways (ancillaries), lighting and soft estate. This continues to be reflected in the plans for 2025-26. As we have reflected in our advice to DfT on the development of the capital specification for 2025-26, National Highways must set out more clearly the outputs and outcomes that it intends to achieve with this funding. It must also demonstrate it is investing in the right assets at the right time in line with its overall strategic approach to renewals. This will ensure that we can hold the company to account to deliver efficiently and in line with its plans during 2025-26 and to assess whether the identified need has been addressed.

2.26 Based on the overall funding allocated to renewals, and the distribution of funding by asset type, we conclude that National Highways' plans are likely to be deliverable. However, given the funding allocated, we have yet to see evidence that volumes of renewals proposed have been set at a sufficiently challenging and efficient level. For example, for flexible pavement assets, the company consistently delivers in the region of 1,600 lane kilometres of renewals each year. Therefore, it needs to evidence why it is only proposing to complete around 1,300 kilometres in 2025-26.

2.27 As illustrated in Table 2.3, where comparisons can be drawn, National Highways has reduced the level of outputs it proposes to deliver in 2025-26 per pound of spending. Generous inflation allowances were included in the renewals plans set out in the interim draft SBP and therefore increasing prices do not account for the implied increase in unit cost. All things being equal, this suggests plans are less efficient than those put forward in the interim draft SBP.

2.28 Before finalising its plans for 2025-26, National Highways should review the proposed output levels and provide evidence to demonstrate that the plans will deliver the same performance expectations and are at least as efficient as delivery costs in 2024-25 would suggest.

Table 2.3 Planned renewals output volumes and implied unit cost

	Measure	Interim draft SBP 2025-26	Implied unit cost (£000s per km)	Current proposals 2025-26	Implied unit cost (£000s per km)
Pavements - flexible	Lane km	1,617	167	1,315 +/- 2%	247
Pavements – rigid	Reconstruction – Lane km	27	3,092	22	2,091
	Life extension – Lane km	63	420	0	NA

Safety Barriers	km	238	248	228 to 294	252 to 325
Significant Structures	No.	38	-	Not provided	
Roadside Tech	CCTV	Not provided	-	385	-
	Signs	Not provided	-	241	-
	Signals	Not provided	-	298	-
	Total assets	Not provided	-	923	-
Drainage	Hotspots mitigated	*40* to 50**	-	31 to 51	-
	Reduction in flooding events	2,483	-	Not provided	-
Geotech-nical	Schemes	30	-	Not provided	-
Lighting	No. of columns	1,200	-	Not provided	-
Soft estate	Half of all soft estate at ‘Condition grade 5’ during RP3		-	Not provided	-

*Note: Information shared by National Highways in November 2024 and not provided in the interim draft SBP or subsequent engagement.

Specificity of plans

2.29 The information provided in Table 2.3 highlights the need for National Highways to provide clear and unambiguous information on its renewals plans so that, during 2025-26, we can verify that the company is delivering both efficiently and in line with its plans. For example, it has indicated that the increase in unit cost of flexible pavements may be due to an increase in the proportion of deeper pavement renewals, which are considerably more expensive. However, it has not provided a breakdown of its 2025-26 plans by pavement depth. Similarly, the cost of safety barrier renewals depends on the proportion involving full replacement versus repair, but this information has also not been supplied for 2025-26. DfT should consider including incorporating such details into its capital specification for 2025-26, as well as ensuring the specification addresses all asset types outlined in Table 2.3.

2.30 Drainage provides a further example of where more specific plans and detailed reporting would be beneficial. During RP2, the company reports the volume of drainage renewals in terms of kilometres of drainage assets renewed. In its interim draft SBP, however, the company's plans were modelled on the basis of limiting the number of flooding events on the network. Its plans for 2025-26 are expressed as the number of flooding hotspots that will be addressed. These changes in measurement approach make it challenging to compare the 2025-26 plans with either current levels of delivery or the interim draft SBP.

2.31 During 2025-26 the company should report both the kilometres of drainage asset renewed, and the number of flooding hotspots addressed. Additionally, it should regularly report the number of flooding events on the network through its quarterly reports, as this measure underpins its long-term plans. This approach would provide visibility into how its maintenance and renewal strategies influence outcomes, alongside external factors such as climate change.

Concrete pavement renewals

2.32 As noted, we have had limited opportunity to conduct a detailed review of asset-level plans for 2025-26. However, the information provided to date raises questions regarding the planned spending on the concrete roads programme. This programme is designed to manage and address ageing and life-expired concrete roads on the SRN. Rigid pavements are understood to fall short of current performance expectations and are generally disliked by users.

2.33 National Highways aims to replace all ageing concrete pavements on its network by the end of the sixth road period (2045). The company considered that this timescale achieves a reasonable balance between the need to improve performance and reduce the risk of failure, and to ensure that its programme is affordable and deliverable within each road period. However, it is yet to provide a plan demonstrating how this longer-term aim can be achieved.

2.34 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.

2.35 As previously described, in 2025-26, National Highways will complete the overrunning M27 reconstruction scheme. As shown in Table 2.2, the total amount allocated to concrete roads is £75m. The expected cost of the M27 scheme in 2025-26 is understood to be £46m. However, the company has indicated that no other reconstructive or life extension renewals will be delivered during this period. Of the remaining £29 million, £6.5 million will be used by regional teams for the design of upcoming schemes, while £22.5 million will be allocated to the national concrete roads programme for activities including optioneering, condition surveys, and innovation work.

2.36 While we appreciate the need to undertake surveys, programme development and innovation, the proposals appear heavily weighted towards these activities, rather than on-the-ground delivery. Before finalising renewals plans for 2025-26 the company must provide evidence to justify the high costs associated with design, development and innovation activities and demonstrate that this approach is efficient and will deliver optimal outcomes for users both in the short- and long-term.

Enhancements

2.37 DfT has asked National Highways to continue delivering the portfolio of schemes included in its second road investment strategy (RIS2), excluding those cancelled following the General Election and the Autumn 2024 Budget. No new enhancements schemes have been added to the portfolio in 2025-26. We understand that the company is acting on the basis of letters exchanged between DfT and National Highways before and after the general election. However, we have not seen DfT’s requirements translated into a set of specific milestones.

2.38 Our advice in this area is based on a rapid review of limited information provided by National Highways from its business planning process and comparison against plans for 2025-26 in its interim draft SBP. Updated details of project milestones and project-level risk assessments were not provided in time for us to fully consider during this review. As such it is based on high-level information and very limited project-level examination. Therefore, if time permits, we propose to provide further advice to DfT as more detailed information comes forward.

2.39 National Highways forecasts that the remaining cost of the portfolio has increased from £5,001 million to £5,875 million as compared with the last update provided by the company during the efficiency review process. This is primarily due to changes on the A66 Northern Transpennine (A66) and A12 Chelmsford to A120 projects. We did not see the detail of outturn forecasts beyond 2025-26 in time for them to be fully considered as part of this review and so have not been able to fully compare them against the interim draft SBP. However, the cost that the company expects to incur in 2025-26 has fallen by £304 million (relative to the interim draft SBP) to £1,175 million. Although detailed explanation has not been provided we assume this is a result of enhancements projects being deferred or delayed.

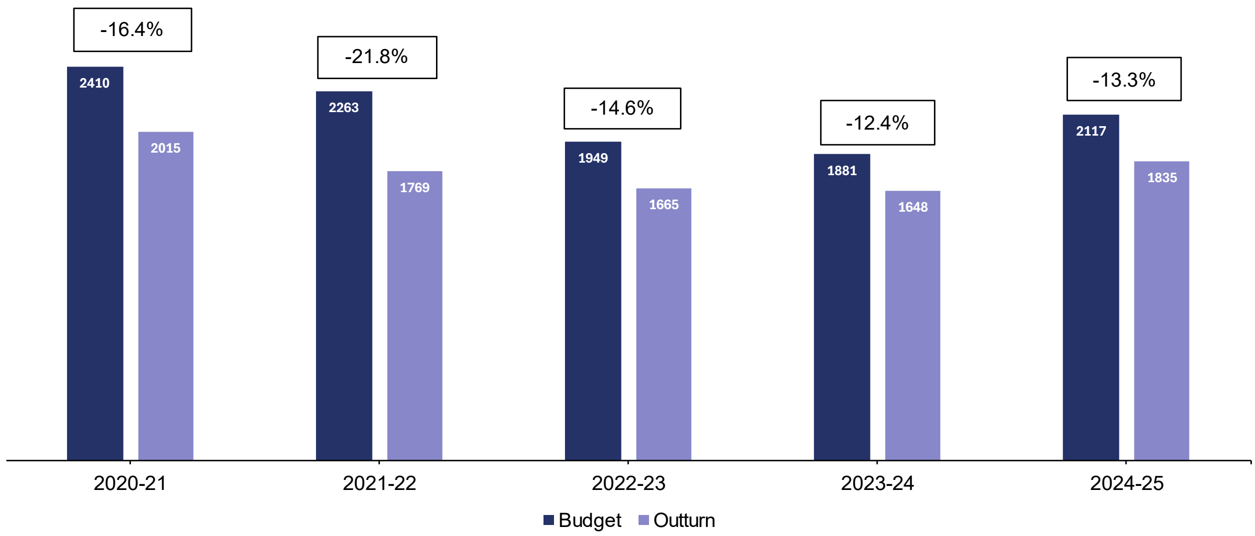
Table 2.4 Enhancement cost comparison (£ million, nominal)

	Interim draft SBP 2025-26	Current proposals 2025-26
Existing enhancements commitments	1,479	1,175
New enhancements	8	-
Future RIS and scheme development	35	27
Lower Thames Crossing	349	250
Subtotal	*1,871*	*1,452*
Overprogramming (LTC & A66)	-	-71
Total	**1,871**	**1,381**

2.40 In our advice on the interim draft SBP, we concluded that National Highways' cost estimates for enhancement projects, over a five-year period were likely to be understated, making further cancellations or deferrals inevitable unless additional funding was provided. However, cost escalation and delays are often interlinked. Focusing specifically on 2025-26, emerging risks are more likely to result in a further reduction in cost in 2025-26 as the company defers activities to the third road period (RP3, 2026-2031).

2.41 This conclusion is supported by two factors. Firstly, during RP2, National Highways has tended to underspend against its annual enhancement budget. This is illustrated in Figure 2.1. In 2024-25, the company started the year with £320 million of capital 'pressure'. This pressure increased by a further £50 million following the spending review. The company has managed to absorb a significant amount of this and, by October 2024, the remaining pressure was £60 million. This has been achieved primarily through planning delays, cancellations and rephasing of several large projects including, A303 Stonehenge, A66 and the A47 schemes.

Figure 2.1 Enhancements forecast accuracy (£ millions, nominal)



2.42 Secondly, decisions to progress with several enhancement schemes currently in development are subject to a spending review that will not complete until mid-way through 2025-26. National Highways' project-level cost estimates assume timely decisions are made to progress with these schemes as currently planned. As such, there are significant risks that some projects will not progress in line with their current programmes. While this is likely to increase the outturn cost of schemes, it will likely reduce costs incurred in 2025-26.

2.43 National Highways has identified specific significant risks for several schemes relating to these timely decisions. It estimates that, if these risks are realised, they would lead to a reduction in spend in 2025-26 of between £81 million and £124 million. Based on the assumed start of works (SoW) milestone dates we received late in this review, the risks appear to broadly correlate with those assumptions. However, the company's analysis excludes the Lower Thames Crossing (LTC) project and does not include the M3 Junction 9 scheme which is currently going through the change control process to push back a 2024-25 SoW milestone. As such, the total of the risks identified by the company is likely to be an underestimate.

2.44 National Highways has partially addressed this issue by incorporating an 'overprogramming' adjustment of £71 million for the two largest schemes in the portfolio: the A66 and LTC. Including an ‘overprogramming’ adjustment acknowledges the reasonable likelihood that the actual funding required will be lower than the current cost estimates. This appears to be a prudent method for managing uncertainty in these projects.

2.45 Our preliminary assessment, based on the evidence provided to us at this time, is that even with the ‘overprogramming’ adjustment of £71m, an underspend on enhancements appears more likely than an overspend. In this context, maintaining funds in a Central Risk Reserve (CRR) – the purpose of which is to manage risks that lead to higher cost – is unlikely to be justified in the current circumstances. Setting the CRR to zero would reduce the current capital funding gap from £115 million to £65 million. Further consideration of the role of the CRR in 2025-26 is provided in paragraphs 2.67 to 2.72.

2.46 Although the precise figures will inevitably change before plans are finalised, the remaining capital funding gap could be managed by increasing the ‘overprogramming’ by £65 million from £71 million to £136 million. This degree of funding gap appears manageable given the experience of RP2 and remaining risks and uncertainties about the enhancement portfolio.

2.47 Retaining a significant level of ‘overprogramming’ effectively accepts that some projects will not be able to progress according to currently planned timescales. Delaying projects inevitably introduces inefficiencies. While we would normally expect direct alignment between plans and funding levels, we consider this to be a reasonable approach in the context of constrained funding and current uncertainties.

2.48 Given the remaining uncertainties surrounding the enhancement portfolio, unless firm commitments are given, National Highways, alongside government, should explore options to restrict discretionary spending of public money on projects that will remain in the development phase until RP3. During RP2, 20 enhancement projects have been removed from the programme. We estimate that the total spend on developing those projects was £833 million, with £182 million spent during RP2.

2.49 A66 and LTC are key examples of projects subject to decisions that will be taken mid-way through 2025-26. Planned spend on these projects in 2025-26 is largely, or entirely, on advance works. We recognise that, should a project go ahead, completing these works early can enable more efficient delivery. However, the company, and government, must also consider the risk of incurring further unrecoverable expenditure, and carefully balance the two.

2.50 The extent to which an underspend on enhancements poses a challenge largely depends on whether capital flex arrangements – allowing National Highways to carry forward a portion of its capital funding to the next financial year – remain in place. In the absence of such arrangements, the company should proactively consider options to reallocate funding to renewals or other capital programmes during 2025-26, should a surplus arise. Any reallocation of funding should be undertaken in a transparent manner.

Future RIS and scheme development

2.51 National Highways has included £27 million in its plans for RIS3 development (£14 million) and developing its future enhancement pipeline (£13 million). The pipeline development funding is scaled back from the £27 million in the interim draft SBP to reflect government requirements. The company has provided details of the remaining projects in its pipeline and we recommend that the expected progress with these projects (at an appropriate level of detail) should be captured in the capital specification to ensure that they progress at a suitable pace. In contrast, funding for RIS development in 2025-26 has increased from £8 million in the interim draft SBP to £14 million in the latest plans. National Highways' narrative rationale is that this relates to the continued negotiations around setting RIS3. We have seen no evidence to explain or justify this increase in cost.

Designated Funds

2.52 National Highways has been developing the concept of new safety and environment focused National Programmes to sit alongside Designated Funds. National Programmes are intended to respond to legal requirements, mandatory obligations or government objectives. However, the National Programmes will not be formally launched until the start of RP3. Therefore, for 2025-26, development work and other activities related to the National Programmes has been brought within the Designated Funds spending line. The company has also included the new small scheme fund under Designated Funds, whereas, in the interim draft SBP, this was included as part of enhancements. In line with our advice in its interim draft SBP, it has removed the previously proposed operational technology National Programme which is now included in the renewals programme.

2.53 As shown in Table 2.5, once the various reclassifications of funding are considered, the amount the company plans to spend on Designated Funds will increase by £30m. This is due to the inclusion of safety schemes originally planned for 2024-25. These safety schemes were intended to help the company meet its RIS2 target for reducing the number of Killed and Seriously Injured (KSI) casualties on the network which runs till December 2025.

2.54 Funding for other activities is unchanged, but National Highways has not clarified how it will distribute funding across the various priorities. The company has told us that it is still in the process of reviewing the deliverability of these funds. The evidence it has presented does not remedy our earlier concerns, raised in our advice on the interim draft SBP, about the lack of detail in these plans and its ability to readily deliver on the priorities it has identified.

Table 2.5 Designated funds and National programmes spending lines (£ million, nominal)

		Interim draft SBP 2025-26	Current proposals 2025-26
Small schemes programme		5	**Breakdown not provided**
National programmes	Safety	5	
	Environment	18	
	Operational technology	59	
Designated funds	Safety	9	
	Environment	12	
	Customers & communities	9	
	Innovation	6	
Total		**123**	**94**
Total (excluding op. tech. national programme)		**64**	**94**

2.55 National Highways' proposed level of spending indicates that it will rely on an existing pipeline of capital projects already in development. The company must provide DfT with clearer information on the projects it is committed to deliver in

2025-26. It should also demonstrate that design and development work to prepare for RP3 and the delivery of obligated outputs / outcomes are commensurate with planned spending.

2.56 In our review of the interim draft SBP, we raised concerns about National Highways' readiness to hit the ground running in 2025-26 in respect of Designated Funds, National Programmes and other capital initiatives. We have yet to see evidence that these concerns have been addressed. As capital spending plans in these areas undergo further assessment this may highlight deliverability issues leading to a modest reduction in planned capital spending and, therefore, the capital funding gap.

2.57 It is the government's role to determine the priorities to be pursued. However, Designated Funds are most effective when objectives and outcomes are clearly defined, such as in corridor-based safety improvement initiatives or efforts to mitigate polluting outfalls. If a pipeline of projects can be identified, these funds can provide a useful lever for the company when dealing within uncertainty surrounding the enhancement programme and the level of pressure on capital funds. Nevertheless, resources should only be allocated to these funds where National Highways can identify viable and good value for money projects, clearly aligned with wider obligations and government commitments.

Digital and corporate services

2.58 National Highways has provided limited details of changes to its digital and corporate services plans. In overall terms the company has revised its cost estimates up by £41 million. The reasons provided to explain the increase are:

(a) higher costs linked the government pay award and the increase in National Insurance;

(b) an adjustment to corporate technology costs to align planned spending with forecast outturn costs in 2024-25;

(c) an increase in planned investment in the company's estate, and;

(d) acceleration of the company's programme to install LED lighting on the network.

2.59 Set against these increases, National Highways has reallocated staff in its commercial and procurement team to other divisions and reduced the amount of funding allocated to campaigns and safety initiatives.

2.60 These changes result in an overall increase in cost of £41 million (7%) in 2025-26. This is due to higher capital costs and revenue costs are slightly reduced. To date, we have yet to see sufficient detail of the various changes to assess whether an increase of this scale is warranted. At this stage, our primary observation is that there is limited evidence that digital and corporate services plans for 2025-26 have been fully challenged. Revenue costs amount to £236 million and, therefore, finding savings in this area is likely to be key to eliminating the funding gap while minimising direct impacts on users and performance.

Table 2.6 Comparison costs (£ million, nominal)

	Interim draft SBP 2025-26	Proposal plan 2025-26
Corporate services (Revenue)	169	160
Corporate services (Capital)	149	180
Corporate technology (Revenue)	73	76
Corporate technology (Capital)	67	53
Estates (Capital)	59	69
Corporate carbon (Capital)	37	57
Total	**554**	**595**

2.61 National Highways has increased the amount it intends to spend on investments in the company’s operational estate. As reflected in our advice to DfT on the development of the capital specification for 2025-26, given the scale of funding allocated to estates, it is important that the company provides specific details of the outputs this will achieve, both to ensure it will contribute to required outcomes and so we can hold it to account for delivering on its plans.

2.62 A further area where National Highways has increased its capital spending plans is in respect of its corporate carbon initiatives. Specifically, the company has brought forward spending on its LED lighting programme so that it can achieve its objective to replace 70% of lighting on the network with LED lanterns by 2027.

2.63 A total of £22m was allocated to the LED programme for 2025-26 in the interim draft SBP. National Highways now reports that it has allocated a further £20m, implying that the total is now £42m. Based on evidence of the cost of installing LEDs during RP2, this level of funding should be sufficient to install in the region of 15,000 LED lanterns. The company has told us it expects to have replaced around 53,000 LEDs, or 60% of all lighting by the end of RP2. Therefore, only a further 9,000 LEDs would be required to achieve 70%. In conclusion, the evidence currently available to us suggests that, either National Highways will achieve the 70% target much sooner than 2027, or the unit cost of delivery in 2025-26 is significantly higher than has been the case in RP2. The company should clarify planned LED replacement volumes and costs before the interim settlement is finalised.

2.64 Subject to National Highways demonstrating that its unit cost assumptions are efficient, replacing conventional lighting with LEDs is likely to offer good value for money because they are more durable and reduce energy consumption in the long-term. However, in other areas of the corporate carbon programme, it is not clear what National Highways is intending to deliver for the investment it has requested during 2025-26. In our advice on the interim draft SBP, we detailed concerns about the maturity of these plans and therefore the company needs to provide DfT with assurance that they offer a robust and cost-effective means of reducing emissions.

Protocols

2.65 The overall amount allocated to protocols is similar to that included in the interim draft SBP. National Highways suggests that, as things stand, there would be sufficient funding for the deployment of Operation Brock during peak holiday periods. Therefore, if the introduction of the European Union’s Entry Exit System (EES) causes disruption which requires further deployment this will lead to an overspend unless additional funding is provided.

2.66 National Highways has stated that it may need to consider further options to cut protocols funding to close the revenue funding gap. As for other areas, the company needs to set out options for doing so and their likely impact so that they can be weighed against other options.

Central Risk Reserve

2.67 Financial risks are currently managed through a Central Risk Reserve (CRR), a mechanism introduced during RP2 to centrally manage and balance risk across the company's enhancements and renewals programmes in line with best practice. For 2025-26, the company has allocated £50 million to the CRR.

2.68 In general, we support the principle of holding a risk allowance centrally to manage uncertainty in a transparent manner. However, based on the information provided to date, the nature of the uncertainties surrounding the enhancement programme suggests that the risks are more heavily weighted towards an underspend on capital rather than an overspend. As such, including capital funding in the CRR is unlikely to be justified.

2.69 The CRR is not exclusively for enhancements. However, historical data from RP2, as illustrated in Figure 2.2, demonstrates that the company has typically underspent its overall annual capital budget, not just its enhancement budget.

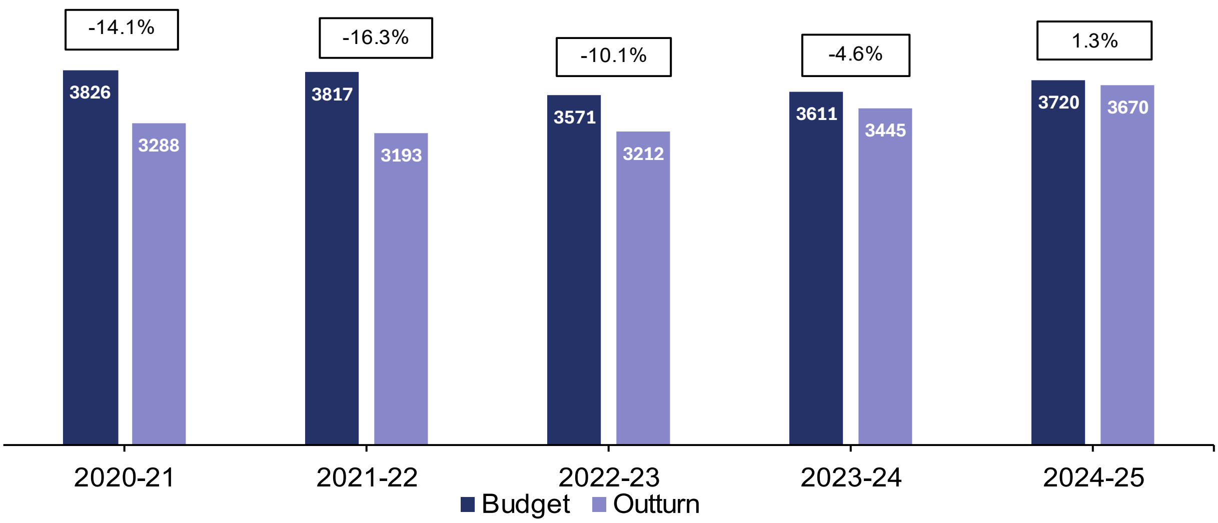


Figure 2.2 Budget vs Outturn Capital

2.70 For renewals, plans and cost estimates are expected to be more reliable when considering a one-year timeframe. While National Highways anticipates delivering a growing number of very large renewals schemes in RP3 – projects that often carry significant financial risk – relatively few of these are expected to be in construction during 2025-26. Furthermore, as noted in paragraph 2.18, National Highways has employed relatively conservative assumptions in its estimate for the cost of addressing damage to network property which could provide the company with a small degree of flexibility to reallocate funding to 'core' renewals activities if risks emerge. As such, we proposed that risk is managed within the renewals programme and budget. Additionally, based on the evidence provided, the likelihood of overspending in other capital areas appears low.

2.71 The reporting and governance structures surrounding the CRR provide essential transparency regarding programme changes during a road period. To maintain these benefits without fully suspending these arrangements, it is proposed that the CRR be set to zero.

2.72 A key aspect of this recommendation to set the CRR to zero and over-programme the enhancement portfolio is the assumption that any underspends on specific projects or programmes will be credited to the CRR rather than automatically clawed back. This ensures financial flexibility while maintaining transparency.

Inflation assumptions

2.73 National Highways has not provided information on any of the inflation assumptions underpinning its current cost estimates. Over a one-year horizon, inflation assumptions have a relatively limited impact on cost estimates. However, the level of inflation will inevitably influence the company's costs, either directly or through inflation indexation mechanisms embedded in its contracts. This is exemplified by the fact that the company has stressed that a 'flat cash' revenue funding settlement will pose a significant challenge because it will require it to absorb increasing wages, prices and DBFO costs.

2.74 Up-to-date and appropriate inflation assumptions are required to generate accurate forecasts, yet these are not transparent. Notably, with respect to revenue, the risks associated with a funding gap are delicately balanced, making inflation assumptions a potentially significant factor in determining the preferred option to improve affordability.

Efficiency

2.75 Improving efficiency is a long-term process best suited to longer-term targets. Multi-year road settlements were a key aspect of roads reform, designed to give National Highways and its supply chain the certainty needed to plan and invest for the future, thereby enhancing efficiency. Nevertheless, we expect the company to pursue all opportunities to maintain and improve efficiency ahead of and during 2025-26.

2.76 In the timescales for this review, we haven't had the opportunity to review the efficiency of National Highways' plans in detail. The company has provided limited information on the activities it will undertake or the level of outputs it will deliver in key areas such as renewals and designated funds. Our initial review suggests that plans are less efficient than those put forward in the company's interim draft SBP for two main reasons. Firstly, as illustrated in table 2.3, for asset types for which indicative targets have been proposed, the level of outputs appears lower than previously suggested while the overall funding level is broadly the same. Evidence has not been provided to justify this is an equivalent plan. Therefore, further work is required to establish the level of outputs that will be delivered across all asset types and verify that this is at least commensurate with the company's efficiency at the end of RP2.

2.77 Secondly, cost estimates for operations, corporate services and digital are higher than either the level proposed in the interim draft SBP, or the level of spending in 2024-25. Some of the increases in cost are explained by an increase in planned activity (such as more investment in the company's estates) but not all. The reasons for these increases need to be examined in more detail. However, we expect that costs will come down in some of these areas as the company adjusts its plans to close the funding gap.

3. Overall conclusions

3.1 Based on National Highways' estimates, the company's emerging proposal for 2025-26 exceeds available funding by £169 million, of which £115 million is capital and £54 million is revenue. We have undertaken a rapid, high-level review of developing proposals and considered whether emerging capital and revenue spending plans are affordable and deliverable within the available funding.

3.2 Based on the overall funding that National Highways has allocated for renewals, we conclude that the company's plans are likely to be deliverable. However, we have yet to see evidence that the proposed volumes of renewals are sufficiently challenging given the funding allocated. Before finalising its plans for 2025-26, the company should review the proposed output levels and provide evidence demonstrating that the plans will deliver the same asset performance and are at least as efficient as delivery costs in 2024-25 would suggest.

3.3 National Highways' assessment of enhancements costs for 2025-26 is founded on reasonable and up-to-date assumptions. However, it is more likely that the company will underspend against its current estimates than overspend. Our current view is that the level of funding is likely to be adequate. The funding gap could be addressed by setting the Central Risk Reserve (CRR) to zero and accepting a higher degree of overprogramming of the enhancement portfolio.

3.4 While we would normally expect direct alignment between plans and funding levels, this is likely to be a reasonable and appropriate approach given known risks and will require careful management. The level of overprogramming could be reduced before the interim settlement is finalised by taking pre-emptive decisions to slow the progress of some schemes to reduce exposure to potentially abortive costs where those schemes are subject to decisions still to be made by government.

3.5 In other areas of capital spending, National Highways should firm up its delivery plans and cost estimates, set out delivery commitments commensurate with the proposed level of funding and obligations it is required to deliver, and consider how it could scale up or down these plans during 2025-26 in response to changes in available funding as the position on enhancement schemes solidifies.

3.6 Closing the funding gap will be more challenging for revenue expenditure than capital expenditure. Further analysis of options for reducing cost and their impact is required. However, based on the evidence currently available, it appears feasible for National Highways to operate and maintain the network within this funding envelope with limited implications for performance during 2025-26, provided that further significant cuts to maintenance are avoided. However, there will be implications in future road periods unless additional funding is made available early in RP3. The company must prioritise presenting these choices to DfT. It must evidence not only the impact of its preferred options but also provide evidence to support decisions to protect funding and demonstrate that its preferred strategy minimises impacts on safety and performance.

3.7 In all areas, it is imperative that the company clearly sets out the assumptions upon which its plans are based so they can be used to understand the reasons for any deviation from expected performance during delivery.

3.8 Plans for 2025-26 continue to evolve and we will work closely with the DfT and the company to offer ongoing advice and guidance as the interim settlement is finalised where feasible in the time available.

Annex A: Annex: Financial proposals

A full breakdown of National Highway's financial proposals is provided in table 3.1. This compares current proposals to those provided in the company's interim draft SBP.

Table 3.1 National Highways Financial proposals

		Interim draft SBP 2025-26	Current proposals 2025-26
Operating and Maintaining the Network	DBFO (Revenue)	634	619
	Maintenance (Revenue)	305	267
	Operations (Revenue)	157	168
	Operations (Capital)	145	184
	Operational Technology (Revenue)	105	113
	Operational Technology (Capital)	24	46
	Network Electricity (Revenue)	45	42
Renewals	Flexible pavements	270	324
	Structures	373	339
	Rigid pavements	136	75
	Roadside tech	119	119
	Vehicle road systems	59	74
	Drainage	78	85
	Geotechnical	46	34
	Ancillaries	60	81
	Lighting	54	40
	Soft Estates	32	28
	Tunnels	22	23

<table>
<tr><th colspan="2"></th><th>Interim draft SBP 2025-26</th><th>Current proposals 2025-26</th></tr>
<tr><td></td><td>Damage to Network Property (DNP)</td><td>N/A</td><td>60</td></tr>
<tr><td rowspan="2">Existing Enhancement Commitments</td><td>RIS tail</td><td>1,479</td><td>1,175</td></tr>
<tr><td>Other Enhancements</td><td>0</td><td>0</td></tr>
<tr><td rowspan="3">New Enhancement Commitments</td><td>A14 J10a</td><td>3</td><td>0</td></tr>
<tr><td>Smart Motorways Retrofit</td><td>0</td><td>0</td></tr>
<tr><td>Small Schemes £5-50m</td><td>5</td><td rowspan="8">94</td></tr>
<tr><td rowspan="3">National Programmes</td><td>Safety</td><td>5</td></tr>
<tr><td>Environment</td><td>18</td></tr>
<tr><td>OpTech</td><td>59</td></tr>
<tr><td rowspan="4">Designated funds</td><td>Safety</td><td>9</td></tr>
<tr><td>Environment</td><td>12</td></tr>
<tr><td>Customers and Communities</td><td>9</td></tr>
<tr><td>Innovation</td><td>6</td></tr>
<tr><td rowspan="2">Future RIS and Scheme Development</td><td>RIS development</td><td>8</td><td>14</td></tr>
<tr><td>Future Enhancement Pipeline</td><td>27</td><td>13</td></tr>
<tr><td rowspan="2">Central Risk Reserve</td><td>Existing commitments</td><td>42</td><td rowspan="2">50</td></tr>
<tr><td>Renewals</td><td>51</td></tr>
<tr><td rowspan="5">Digital and Corporate Services</td><td>Corporate services (Revenue)</td><td>169</td><td>160</td></tr>
<tr><td>Corporate services (Capital)</td><td>149</td><td>180</td></tr>
<tr><td>Corporate technology (Revenue)</td><td>73</td><td>76</td></tr>
<tr><td>Corporate technology (Capital)</td><td>67</td><td>53</td></tr>
<tr><td>Estates (Capital)</td><td>59</td><td>69</td></tr>
</table>

		Interim draft SBP 2025-26	Current proposals 2025-26
	Corporate carbon (Capital)	37	57
Protocols	Protocols including Historic Rail Estate and Operation BROCK (Revenue)	80	64
	Protocols including Historic Rail Estate and Operation BROCK (Capital)	8	19
Lower Thames Crossing	Lower Thames Crossing	349	250
Unfunded activity		0	10
Over-programming	Lower Thames Crossing	NA	-50
	A66 Northern TransPennine	NA	-21
Total	Revenue	*1,567*	*1,509*
	Capital	*3,821*	*3,425*
	GRAND TOTAL	**5,388**	**4,934**

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