

Finance, Performance and Resources Select Committee 29 September 2015

Agenda Item	Page No
8 PRUDENTIAL BORROWING - VALUE FOR MONEY ARGUMENT "To follow" report attached	3 - 18



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Buckinghamshire County Council Select Committee

Finance, Performance and Resources Select Committee

Report to the Finance, Performance and Resources Select Committee

Title: Prudential Borrowing for Highway Infrastructure
Committee date: Tuesday 29 September 2015
Author: Chairman of the Select Committee
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Purpose of Agenda Item

The following recommendation was made in the last budget scrutiny report:-

“We queried the amount it would take to bring roads back to an acceptable level and restated our view that borrowing should be the main funding method, as opposed to the use of reserves. We also noted several of the Cabinet Members [at that time] had endorsed this view during the hearings and that successive budget scrutiny reviews had made this a recommendation. We restate this recommendation and go further in requesting that it be formally evaluated as an option in public by Cabinet.”

At the July meeting Members discussed a report which looked at the value for money arguments for prudential borrowing in public to identify whether there were any recommendations that could be made around financing of the capital programme. Following this discussion Members views would be welcomed on whether they would like to make any recommendations to Cabinet by considering Appendix 1 of this report.

Recommendations

- 1. To note the discussion on prudential borrowing but take no further action**
- 2. To ask Cabinet to consider using prudential borrowing to invest in highway infrastructure by looking at the options in the report (para 42 to 52) whilst being mindful of the need to minimise the impact on revenue by using existing revenue contributions to capital to finance any supported borrowing.**





Buckinghamshire County Council

Finance Performance and Resources
Select Committee

Value for money argument in relation to prudential borrowing for Highways Infrastructure



Executive Summary

Recommendations

1. To note the discussion on prudential borrowing but take no further action
2. To ask Cabinet to consider using prudential borrowing to invest in highway infrastructure by looking at the options in the report (para 42 to 52) whilst being mindful of the need to minimise the impact on revenue by using existing revenue contributions to capital to finance any supported borrowing.

1. Inquiry Context

1. The following recommendation was made in the last budget scrutiny report:-
“We queried the amount it would take to bring roads back to an acceptable level and restated our view that borrowing should be the main funding method, as opposed to the use of reserves. We also noted several of the Cabinet Members [of that time] had endorsed this view during the hearings and that successive budget scrutiny reviews had made this a recommendation. We restate this recommendation and go further in requesting that it be formally evaluated as an option in public by Cabinet.”
2. At the July meeting Members discussed a report which looked at the value for money arguments for prudential borrowing in public to identify whether there were any recommendations that could be made around financing of the capital programme. **Following this discussion Members views would be welcomed on whether they would like to make any recommendations to Cabinet.**
3. Local Authorities are only allowed to borrow for capital purposes and the financing costs of any borrowing must be met from revenue. This covers the repayment of the loan (capital) and the interest charge on the loan (revenue). The Local Government Act 2003 requires Council’s to adopt CIPFA’s Prudential Code and a range of Prudential Indicators to help demonstrate that the Council’s capital investment plans are affordable, prudent and sustainable. These indicators are incorporated within the Treasury Management Strategy, which is approved by full Council before the start of each financial year.

http://www.audit-scotland.gov.uk/docs/local/2015/nr_150319_borrowing_treasury_management_supp.pdf

2. National Context showing the need for investment in highway infrastructure

4. An LGA document states that whilst prudential borrowing can only be used as a source of capital expenditure, it could help authorities reshape services to meet changing demands and undertake transformational programmes.
 - Meeting service needs and improvements
 - Cover Service pressures in other departments
 - Better procurement
 - Better capital programming and to provide an immediate stream of capital
 - Partnership working
 - Pressures to keep council tax increases at a low level

Funding Innovation: Local Authority Use of Prudential borrowing (LGA document)

http://www.local.gov.uk/c/document_library/get_file?uuid=92c23c04-791d-4090-9a09-9aa5643d4958&groupId=10180

5. **The LGA Document 'Better Roads for England' refers to the Government forecast of a 42 per cent increase in traffic and 61 per cent increase in congestion levels on the local roads network. There is also a maintenance time-bomb and it is estimated the current backlog of road maintenance would cost £12 billion (nationally) to fix and would take around 10-12 years to clear. Addressing the backlog, a more stable funding stream, and moving towards preventative maintenance would also save money in the long run.**

http://www.local.gov.uk/documents/10180/5854661/L14-473+Better+Roads+for+England_11.pdf/a7a5fec1-dd21-4220-a9f4-f9d4c2cee778

6. Longer-term certainty of roads investment would allow construction firms to better plan their needs in terms of equipment and resources. Instead of preparing for each individual project tactically, maximising their profit from an individual piece of work, they can begin to think strategically about how they can get the best return from the market as a whole (see Surrey County Council case study). In the Netherlands, moving from a one to two year planning horizon to a five to seven year vision resulted in savings of around 20 per cent on maintenance spending.
7. A presentation at Information Zone at the Local Government Association Conference related to Highway Infrastructure and referred to the following value for money survey on asphalt:-

http://www.asphaltindustryalliance.com/images/library/files/ALARM%202015/ALARM_survey_key_findings.pdf

- 8 **Each year the Asphalt Industry Alliance (AIA) commissions a survey of highways departments in all local authorities in England and Wales. The aim of the survey is to build a picture of the general condition of local roads and the levels of maintenance activity as well as the levels of funding required to ensure that they are in reasonable condition.**

- 9 Adept president Matthew Lugg, who is advising the DfT on the highways maintenance efficiency programme, said he was initially "pleasantly surprised" with those local authorities that had good asset management plans and was impressed with how they defended their budgets. "But I'm now surprised more

local authorities are not looking at prudential borrowing to do the same thing," he said. "The numbers stack up in favour of good asset management."

- 10 Sir Merrick Cockell, Chairman of the Local Government Association, said "Despite their best efforts, many councils have been trapped in a false economy of patching up potholes for many years".
- 11 The Civil Engineering Contractors' Association (Ceca) believes a "deep fix" of the nation's highways is needed and it wants the Government to encourage prudential borrowing to help bridge the funding gap. A report for the organisation from the Centre for Economics & Business Research argued that promoting prudential borrowing could fund a "one-off national programme of intensive improvements to local roads" that would significantly reduce longer-term repair costs.
- 12 Alasdair Reisner, Ceca's director of external affairs, said: "Local authorities are sitting on enormous reserves and they have the ability to use prudential borrowing. We're not saying they should spend those reserves but they can use them as a backstop and with prudential borrowing, they could invest over the next five years in a fundamental programme of carriageway improvements that would be a 20th of the cost of coming back and doing remedial repairs".
- 13 Richard Arrowsmith, who leads the Highways Agency's network operations directorate, said asset management is about making informed decisions on performance outcomes, finance and risk. One Authority has commented that officers lack of confidence when presenting management reports to members made it hard to argue the case for funding for highway infrastructure particularly when you are going up against children's services.

3. Case Studies for prudential borrowing

Surrey County Council – Investing money in roads due to improved technology (information research)

- 14 Surrey County Council is using technology that is pothole-proof and new roads are due to be built over the next three years. A total of 177 roads have been lined up to be reconstructed this financial year as part of the Council's **Operation Horizon project**. The other 642 roads in the £100 million initiative to overhaul more than 300 miles of road and grow the economy are set to be spread over the following two financial years. **Each road comes with a 10-year guarantee, meaning the contractor pays for any repairs during that period.** Cost savings targeted are 17.4% over 5 years.

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/325947/Project_Horizon_Surrey_Trial_Projects_Case_Study_130614.pdf

<http://news.surreycc.gov.uk/2015/07/09/surrey-set-to-get-819-more-pothole-proof-roads/>

Select Committee Report on Project Horizon

<http://mycouncil.surreycc.gov.uk/ieListDocuments.aspx?CId=136&MId=3662&Ver=4>

Project Horizon was also considered by the Cabinet as part of the Highways asset management policy, strategy and prioritisation policy and criteria

<http://mycouncil.surreycc.gov.uk/ieListDocuments.aspx?CId=120&MId=3248&Ver=4>

Milton Keynes Council – uses prudential borrowing for highway maintenance

- 15 Members were interested to know whether any Council borrowed for highway infrastructure. Therefore the Corporate Director of Resources at Milton Keynes Council was invited to the last Select Committee meeting to put forward their approach to borrowing.
- 16 Milton Keynes' Highway Infrastructure (roads, footways, redways, streetlights and bridges/structures), having been constructed over a relatively short period of time, required significant capital investment to address the current backlog caused by this asset reaching the end of its 'working life'. They were currently at the point where the asset backlog is growing and they were not arresting this decline with current investment levels, therefore the asset is and will continue to decline.
- 17 In anticipation of this pressure and in line with the Financial Principles adopted by the Council in 2009 to address future liabilities, the Council has since 2011/12 been setting aside £1m of revenue funding each year to contribute towards financing the necessary investment through prudential borrowing.
- 18 By 2014/15, therefore, the Council will have the financial resources to borrow approximately £50m to invest in the repair and replacement of highway infrastructure to start addressing this backlog. If that investment is properly targeted, it will significantly extend the life of the current highway assets and reduce maintenance costs. Indeed, over the long term (25+ years), the investment should be repaid by savings on short term maintenance costs.
- 19 The link below sets out an evidence-based investment programme in highway infrastructure, designed to make best use of the capital resource that is now available.

[Cabinet report](#)

[Appendix to Cabinet Report](#)

[Latest Programme of Investment](#)

Blackpool Council – Prudential borrowing for highway infrastructure (information research)

- 20 Blackpool's highway network is the Council's largest asset (valued at nearly £500m) and is vital to the functioning of the town. It is also an expensive asset to maintain and Blackpool has, in common with other Councils, under invested in maintenance over many years. This has resulted in a gradual but accelerating deterioration of the network which hinders the operation of the town's economy as well as failing to provide the sort of service and street environment which residents demand. Further consequences of the deteriorating network are a large number of costly insurance claims resulting from tripping and slipping accidents and a constant pressure from residents for reactive repairs that deal

with immediate cosmetic and safety problems but that fail to cure long term structural decline.

- 21** The Highways Asset Management Plan has been developed to give an accurate assessment of the condition of the network and the investment required to keep the network in good working order. The gap between investment needed and what is actually spent has been growing resulting in a position where the Council is managing the declining condition of its network. Current available funds are directed into the strategic network and work only takes place in other areas if an inspection determines that condition represents a safety risk, this level of investment creates the climate that members will be familiar with in terms of regular complaints and dissatisfaction with the condition of roads and footways.
- 22** The current pattern of investment can only lead to a continuing decline in the network and a position where in the medium term significant investment will be required to keep the network operational.
- 23** This proposal seeks to interrupt the current cycle of decline in the condition of our roads by early large scale targeted investment aimed at restoring the overall condition of carriageways and footways to a state where they can then be proactively maintained in an overall “steady state”. The proposal aims to achieve this by prudentially borrowing against existing relevant budgets to raise the funding necessary for this early investment, whilst still leaving sufficient funding in those budgets for existing ongoing proactive maintenance.
- 24** Blackpool is fortunate in having a good Highways Asset Management Plan (HAMP) which was approved by the Council on 24th March 2010 and has given the base information to allow investment options to be modelled for the proposal.
- 25** To fund an investment of this scale the Council would need to borrow funds over a 25 year period and fund that borrowing by ring fencing budgets currently targeted at planned and reactive road maintenance and the insurance reserve that pays out for tripping claims to meet the cost of borrowing. Currently the Council is having to pay in excess of £1.5m a year in insurance claims, when this is added to the currently available budgets a sum of £4.2m would be available to support repayment of both principal and interest associated with a total borrowing requirement of £30m. A detailed cash flow is attached at Appendix 5b, to the Executive report.

<http://democracy.blackpool.gov.uk/CeListDocuments.aspx?MID=932&RD=Decisions&DF=12%2f01%2f2011&A=0&R=0>



Appendix 5c.xls



Appendix 5b.xls



Appendix 5a.xls

- 26** The cash flow model in Appendix 5b, to the Executive report, identifies the cost of repayment of the borrowing (both principal and interest), those existing budgets available to support this and the amount of residual budget that would be available to fund existing ongoing commitments. It provides an indicative

profile for the residual budgets which demonstrates how the funding for the ongoing commitments may be distributed and what these figures represent as a percentage of the existing current budgets.

- 27** In addition to the project being able to bring the network to a standard that is required and that the public expect to be delivered, the project would also minimise the potential for insurance claims ensuring available funds are spent on local assets rather than in insurance payouts. This is shown in Appendix 5b, where it had been assumed that the initial investment to remove defects coupled with a continuing robust inspection regime and legal defence would see payouts for claims reduced substantially from a current figure of £1,585,000 to approximately one fifth of this amount. This is a significant factor in financing the borrowing requirement. Information on the number and cost of tripping claims in recent years is shown in Appendix 5c.
- 28** Over time and following the initial investment Council costs in maintaining the network will be reduced as the need to do reactive maintenance to the current levels will be significantly reduced as will the need to handle and respond to complaints about condition.

4 Buckinghamshire Context

- 29** Borrowing decisions made today have a long term impact on revenue budgets. Councils should be trying to smooth their maturity profile to ensure as even a spread of debt and demand on the revenue budgets. Decisions will impact on current and future budgets when finances are already tight, particularly with pressures in childrens and adult services.
- 30** In terms of those Councils who had undertaken prudential borrowing, the Leader at the July meeting commented that almost all were either London Boroughs or unitary councils with different financial models to the County Council. The Leader reported that this Council was using prudential borrowing where there was a good business case but a number of authorities had ran into financial problems because of the high level of revenue payments required to finance their capital borrowing. The Leader expressed concern about using prudential borrowing for roads due to the long term commitment it imposed on the revenue budget and the reduction in financial resilience if emergencies arose such as bad winters impacting on new road surfaces. Also borrowing for roads did not present a good business case.
- 31** Buckinghamshire County Council has invested considerable funding into highways infrastructure over previous years. The £25 million budget setting programme was for the highway network including footways and carriageways but not street lighting. They would use £10 million of this funding to deliver differently by opening up competition to the local market to uplift the quality of the highway network. A recent bulletin was published on the first quarter of Transport for Buckinghamshire resurfacing programme with a substantial number of sites completed.

32 There is an item on the Cabinet Member Forward Plan on the Transport Infrastructure Asset Management Planning Policy, as the DFT are amending their method for allocating funds to Local Authorities for Highways Infrastructure management and maintenance and the need to apply greater rigour to Asset Management Planning. This should also look at value for money overall in terms of the amount of spend on highways in total including the use of new technology (10 year pothole free guarantee and impact on life time of the asset), pothole repairs (see Alarm survey) and insurance claims. Poor roads also cost individuals and businesses in terms of reduced productivity, delayed deliveries and increased fuel consumption.

What is the Councils current approach to borrowing?

33 The level of borrowing as at 1st July 2015 is **£173.3m**. No new external borrowing (except for short-term cash-flow reasons) has been taken out since July 2008. The majority of Council loans are repaid at the maturity date. However, there are a couple of loans which are repaid in equal instalments over the life of the loan. This means that £1.7m of external debt is repaid each year. Over each of the next four financial years £10m of fixed debt will mature. These loans were all taken out in 1989 at an interest rate of 9.125%. This will bring down the average interest rate paid on borrowing, which is currently approximately **6%**. This average rate will further reduce when new borrowing is taken out (see below) as current borrowing rates are low. The budgetary implications of current and approved future borrowing requirements have been taken into account within the Medium Term Financial Strategy.

34 The cost of our current borrowing is **£18.5m** in 2015/16. This is made up of principal repayments ('minimum revenue provision') of **£7.96m** and interest on the debt of **£10.52m**.

35 The current budget assumes new borrowing of **£30m** relating to the Energy for Waste (EfW) plant. The total amount to be paid in May 2016 is £180m. This has been budgeted to be financed from a waste reserve (£50m) and from borrowing (£130m).

36 During 2015/16 the Council is also expecting to borrow **£36m** on behalf of the Buckinghamshire Thames Valley Local Enterprise Partnership (LEP) for Aylesbury Eastern Link Road / Stocklake Link. The LEP will reimburse the costs incurred to the County Council so that the loan is cost neutral to the County Council.

37 Current borrowing rates are at low levels. Variable borrowing can currently be taken out from the Public Works Loans Board (PWLB) at a rate of 1.36% (as at 30th June 2015).

The Value for Money Argument against borrowing for Highway Infrastructure

38 Cabinet approved a 'Capital Investment Strategy' in September 2014. The main objectives of the strategy are to:

- Support the Council's vision, values and priorities, as set out in the Strategic Plan;
 - Support service delivery strategies;
 - Optimise capital resources, investment opportunities and community benefits;
 - Ensure that investments are affordable and sustainable;
 - Maximise "Invest to Save" and "Invest to Contain" opportunities;
 - To carefully consider investment opportunities that can provide the Council with a reliable income stream to support the on-going financial stability of the organisation;
 - Safeguard the on-going integrity of existing assets (property, highways, ICT) ensuring they remain fit for purpose, including reducing the maintenance backlog;
 - Ensure, where appropriate, that investments are in line with the Council's Asset Management Plans.
 - Ensure the long term impact of investment decisions are fully assessed and understood
 - Encourage working in partnership with other organisations to maximise outputs and value for money
 - Ensure that capital and revenue are fully integrated
 - Ensure the health and safety of the public and staff
 - Ensure that there is sufficient contingency in the capital budget to meet emergency needs
- 39** Any capital investment decision which involves prudential borrowing must include the cost of servicing the debt as part of a robust business case. **The Asset Strategy Board, who evaluate all capital investment bids, generally support investment decisions when the cashable cost reductions (or increased income) exceeds the financing costs of any borrowing needed to fund the investment (whether borrowing is then used to finance the scheme or not).** This does assume that the investment bid aligns with council priorities.
- 40** At about the same time as the Capital Investment Strategy was approved some criteria for assessing capital investment decisions in terms of the financial evaluation was considered. The 'hurdle rate' evaluates schemes. It is purely an internal document, which has been used to help with an initial assessment of potential schemes. Schemes such as the EfW plant would pass the 'hurdle rate' test.
- 41** **The current concern is that Highways Infrastructure would not meet the hurdle rate (see July report) as roads continue to deteriorate and funding for borrowing would not be recovered, leaving a debt for future generations.**
- 42** Taking out prudential borrowing to help finance specific capital schemes would have an impact on the revenue budget as the financing costs of borrowing (principal and interest) are funded through revenue. This would mean that compensating revenue savings would need to be found to offset these revenue financing costs. **Recent analysis looking at the financing costs of borrowing £50m for highway improvements showed that the revenue**

implications would be approximately £5.8m per annum for a period of 10 years. Any long-term borrowing would lock in the revenue financing costs for a long period of time and give less flexibility to make savings in a time of austerity.

Information requested by the Chairman of the Select Committee on financial modelling from the Director of Assurance

43 The table below sets out the level of revenue contributions to capital that is currently assumed within the Medium Term Plan (MTP) modelling. The element that relates to the 'New Homes Bonus' has been excluded, as there is uncertainty around this future funding stream.

	2016/17	2017/18	2018/19	2019/20
	£'000	£'000	£'000	£'000
Agreed level of RCC (as per current MTP)	6,012	6,423	6,423	6,423
Less:				
- Planned use of RCC within latest financial modelling (to balance first two years)	(1,539)	(1,782)	0	0
- New Homes Bonus (NHB)	(3,491)	(3,674)	(3,671)	(3,644)
Remaining RCC (excluding NHB)	982	967	2,752	2,779

Option 1 – equal level of borrowing over the next two financial years

44 The maximum level of borrowing that ensures that no financial year ends up with a negative **Revenue Contribution to Capital (RCC)** (unlawful) is **£15m (£7.5m in 16/17 and £7.5m in 17/18)**. The financing costs of this level of borrowing is set out in the table below, together with the remaining level of RCC, should this option be agreed:-

	2016/17	2017/18	2018/19	2019/20
	£'000	£'000	£'000	£'000
Revenue Contributions to Capital (excl. NHB)	982	967	2,752	2,779
Financing costs of borrowing £15m	(120)	(967)	(1,740)	(1,740)
Remaining RCC	862	0	1,012	1,039

45 This option would give a capital roads maintenance budget of **£17.5m in 16/17 & 17/18 and then £10m from 18/19 onwards** (base budget). The impact of this option on the capital programme (from using RCC to finance the £15m) is **£4,567k** over the new MTP period and then **£1,740k** p.a. until the borrowing is fully repaid over a 10 year period.

46 This is on top of the **£3,321k** (£1539k + £1782k) impact already assumed as part of the financial modelling to ensure that Portfolios are not being asked to

find additional savings beyond the £49m already required over the current financial year and following two years.

47 To cover the impact on the capital programme then either the existing capital programme schemes would need to be reduced by an equivalent amount (£4,567k) or further capital resources found (e.g. higher level of capital receipts). Options for reducing the existing capital programme include reducing the schools capital programme (including school places), further reducing property maintenance budget (schools and non-schools) and / or reducing transportation schemes.

48 If the current base budget for capital roads maintenance were reduced to cover the impact of the new borrowing then the revised roads maintenance capital programme budget would be as follows:-

2016/17 = £17.4m
 2017/18 = £16.5m
 2018/19 = £8.25m
 2019/20 = £8.25m

49 Although this would help cover the impact of the borrowing costs in the first two years it would leave a base budget of just £8.25m p.a. from 2018/19 onwards. This is below the deemed level of budget required to maintain the roads at a constant condition (£10m). Therefore, if further funding could not be found to top up the roads programme from 2018/19 onwards then the overall condition of the network would slowly deteriorate. Furthermore, reducing the level of RCC provides less flexibility to deal with revenue pressures in the future.

Option 2 – phase borrowing over the next two financial years (to maximise the overall level of borrowing from using RCC)

50 Borrowing an equal amount in each of the following two financial years’ limits the total borrowing due to the relatively low level of RCC in 2017/18. Phasing the borrowing over the two years allows an overall greater level of borrowing (£24m) to be undertaken. The financing costs of **borrowing £6m in 2016/17 and £18m in 2017/18** is set out in the table below, together with the remaining level of RCC, should this option be agreed:-

	2016/17	2017/18	2018/19	2019/20
	£'000	£'000	£'000	£'000
Revenue Contributions to Capital (excl. NHB)	982	967	2,752	2,779
Financing costs of borrowing £24m	(90)	(960)	(2,752)	(2,752)
Remaining RCC	892	7	0	27

51 This option would give a capital roads maintenance budget of **£16m in 16/17 and £28m in 17/18** followed by **£10m from 18/19 onwards** (base budget). The impact of this option on the capital programme (from using RCC to finance the

£24m) is **£6,554k** over the new MTP period and then **£2,752k** p.a. until the borrowing is fully repaid over a 10 year period.

52 For this option if the current base budget for capital roads maintenance were reduced to cover the impact of the new borrowing then the revised roads maintenance capital programme budget would be as follows:-

2016/17 = £15.1m

2017/18 = £27.0m

2018/19 = £7.25m

2019/20 = £7.25m

53 Again this would help cover the impact of the borrowing costs in the first two years but it would leave a base budget of just **£7.25m p.a. from 2018/19 onwards. This is well below the deemed level of budget required to maintain the roads at a constant condition (£10m) which would result in the overall condition of the network deteriorating at a quicker rate than option 1 from 2018/19 onwards. Furthermore, this option reduces the level of RCC to zero from 2018/19 onwards (excl. NHB), which provides no flexibility to deal with revenue pressures in the future.**

54 On 25 November 2015 an announcement is expected on the New Homes Bonus. Some Council's have combined New Homes Bonus with prudential borrowing to create an investment fund. However, because of future uncertainty around New Homes Bonus this funding cannot be relied upon.

55 Members may wish to consider to ask Cabinet to consider using prudential borrowing to invest in highway infrastructure by looking at the options in the report above (paragraph 42 to 52) whilst being mindful of the need to minimise the impact on revenue by using existing revenue contributions to capital to finance any supported borrowing. This would help provide a small boost to current investment in highways whilst not putting too much pressure on revenue budgets.

56 It is worth noting that one of the benefits of prudential borrowing is that it allows you to borrow a bigger amount of funding at today prices (and not paying these prices in ten years with inflation added each year) and to maximise economies of scale.

5. Moving Forward

57 Members need to decide whether they wish to make a recommendation on prudential borrowing to Cabinet.

58 Whatever the outcome of this discussion, the Council needs to continue with a good Highways Asset Management Plan with a long term strategy and ensuring that value for money is provided in the approach to Highways Infrastructure. Transport needs to be considered as a whole and not as a series of individual issues which is inherently connected to development, housing, health and

planning. Funding allocations need to be set out for periods of at least five years, especially for road maintenance

