Department
for Transport

From the Parliamentary
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David TC Davies MP
Chair
Welsh Affairs Committee
House of Commons
London
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25 APR 2013

Dear David,

When I gave evidence to the Committee on 16 October 2012 covering the Severn Crossings I explained that there would be certain costs that the Government has incurred relating to the Crossings that will need to be recovered following the end of the current concession period. The ability of the Government to continue tolling after the end of the concession is a key part of the Severn Bridges Act 1992 and was made clear during the passage of the legislation. The Department's evidence to the Committee's Inquiry on Severn Crossings tolls in 2010 also noted that there would be debts that would need to be recovered after the end of the concession.

The Highways Agency has published the Severn Bridges Act 1992 accounts annually since 1992. These include the amount falling outside the concession each year, including a high level breakdown of the costs. In December last year I wrote to the Welsh Affairs Committee offering to provide a more detailed breakdown of the costs the Government has incurred relating to the Crossings that will need to be recovered following the end of the current concession.

My officials have prepared a note including a more detailed breakdown and I have enclosed it with this letter. It has taken some time to prepare this breakdown as officials have undertaken some more detailed work to forecast the costs falling outside the concession at the projected end of the concession and to breakdown the costs in more detail than provided in the annual Severn Bridge Act accounts.

The latest estimate of the costs that will need to be recovered following the end of the concession is £88 million, although the final amount will vary depending on factors such as the final level of costs falling outside the concession agreement. Based on a continuation of the current system and current financial performance, the Department expects it to take around one to two years to recover these costs following the end of the concession. The Department will continue to monitor the level of these costs as the end of the concession approaches.

My officials have also shared the attached note with colleagues in the Welsh Government.

I have seen the Committee's recent report on *Crossing the border: road and rail links between England and Wales*. The Government plans to respond to it shortly.

Yours sincerely

STEPHEN HAMMOND

Severn Crossings - Government debts and costs relating to the Crossings

The Severn Crossings are currently managed by a private concessionaire, Severn River Crossings Ltd (SRC). Under the concession agreement the concession will end when a revenue target collected from tolls is reached.[1] Current forecasts are that the concession will end in 2018 but the exact end date will be affected by factors such as traffic volumes and any relevant government changes in taxation.

Types of government debt/costs relating to the Crossings

There are two types of government debt/costs that relate to the Crossings:

1. *Debt to government that SRC is responsible for* – under the concession agreement SRC became responsible in 1992 for most of the existing deficit from the operation and maintenance of the first Severn Crossing. Current forecasts are that the amount to be paid by SRC at the projected end of the concession agreement in 2018 is £274 million.

2. *Costs government has incurred that fall outside the terms of the concession agreement* – under the terms of the concession agreement certain costs fall to the Government rather than SRC (known as the "accumulated deficit"). Under the Severn Bridges Act 1992 the Government is entitled to recover costs falling outside the concession agreement through tolling after the end of the concession. On current forecasts the Department expects these to be £88 million at the projected end of the concession in 2018.

1. Debt to government that SRC is responsible for

At the start of the concession period SRC became responsible for £122m of the existing government debt for construction and maintenance on the first Severn Crossing. SRC repaid £62m of that debt to the Secretary of State on the first day of the concession period and the remaining £60m became a subordinated loan facility that the government invested into SRC.

Under the existing terms of this loan the Secretary of State will be repaid at the end of the concession once all the senior lenders have been repaid. The total repayment to the Secretary of State will be a sum of all of the rolled up interest incurred on the loan and the full principal amount plus indexation that has been incurred on the loan. Current forecasts are that the total amount due will be £274m at the projected end of the concession agreement in 2018. This is a forecast and the final amount will depend on factors such as the end date of the concession and the level of the Retail Prices Index (which affects the indexation payable).

2. Costs government has incurred that fall outside the terms of the concession agreement

As explained above, at the end of the current concession it is expected that there will be outstanding costs outside the concession agreement that the government has incurred that will need to be recovered through tolling (these costs are known as the "accumulated deficit").[2] The accounts of this deficit are presented to Parliament each year following an audit by the National Audit Office.

The concession agreement and Act was structured so that certain risks were borne by Government rather than SRC, for example, costs relating to latent defects on the first Severn Crossing. By bearing these risks the government was able to finance the construction of the second crossing and maintenance of the crossings at a much lower cost. If these risks had been included in the concession arrangement the end date of the concession would have needed to be extended to allow the concessionaire to recover its costs or the tolls would have needed to be set at a higher

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[1] £1.029 billion in July 1989 prices. This figure is likely to be revised again as a consequence of the changes to the rates of Corporation tax in Budget 2013.
[2] The detailed methodology for calculating the "accumulated deficit" is outlined in section 7 and schedule 4 of the Severn Bridges Act 1992.

level. It is also likely that a private company would have required a substantial risk premium in order to take on these risks.

The Highways Agency has undertaken some detailed work to estimate what the accumulated deficit is likely to be at the projected end of the current concession in 2018. On current forecasts it expects the accumulated deficit to be around £88 million at the projected end of the concession agreement in 2018.

In late 2012 the Department for Transport provided the Welsh Affairs Committee and the Welsh Government with an estimated figure for the accumulated deficit of £112 million. This was based on the accumulated deficit in the draft Severn Bridges Act Accounts 2011-12.[3] The £112 million figure represents the amount that would have needed to be recovered through tolling if the concession was to end on 31 March 2012 and SRC were able to fulfil all of its obligations to the Secretary of State for Transport in regard to the subordinated loan. The estimate of £88 million represents the amount that the Government would be entitled to recover through tolling, assuming the concession ended in 2018 as currently projected. The deficit is expected to reduce between 2012 and 2018 as the income due from SRC on the subordinated loan (interest and indexation) is forecast to exceed the costs incurred by the Government (operational costs and notional interest charges). All calculations used to develop this forecast have followed the process outlined in the Act.

The £88 million figure is made up of the following costs:

i. £8m pre 1992 deficit – this relates to existing debt on the first Severn Crossing that was not included in the concession agreement.
ii. £14m of capital expenditure incurred from 1992 to 2012. This includes the cost of freehold land, plant and structures, and machinery.
iii. £40m of operational expenditure incurred from 1992 to 2012. This includes costs relating to latent defects and a large number of agreed additional works not covered by the 1990 concession agreement. As shown in **Annex A**, £16m was paid for additional operational items in the first six years of the concession. These include costs for works on the Severn Bridge that were left outstanding after the major strengthening work that was completed just before the concession. Items include weld defect repairs, completing painting contracts and replacing high mast lights. In the 20 year period there have also been £2m of payments to Gloucester Harbour Trust for mitigations works, including installation and maintenance of a radar system for the navigation rights that have been affected by the Second Severn Crossing.
iv. £12m of other expenditure incurred from 1992 to 2012. It is estimated that over 90% of this is for professional engineering services.[4] The small remaining element relates to legal, audit and other professional fees.
v. £9m of ongoing capital and operational expenditure projected between 2013 and the end of the concession in 2018;
vi. £8m of projected costs associated with the resurfacing of the M48 before the end of the concession in 2018;
vii. (£3m) reflecting the benefit of the interest paid by the concessionaire/SRC exceeding the interest payable to the consolidated fund

See **Annex A** for detailed breakdown of costs incurred between 1992 and 2012.

The £88 million figure is a forecast and there are a number of factors that will affect the final amount:

- The exact level of costs falling outside the concession agreement incurred between 31 March 2012 and the end of the concession. These could vary, for example, as a result of a requirement to carry out unforeseen works relating to latent defects on the crossings.

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[3] These accounts have subsequently been laid before Parliament in January 2013 and this figure has been confirmed. See Severn Bridge Act 1992 Account 2011-12, Income and Expenditure Account p13 http://www.official-documents.gov.uk/document/hc1213/hc09/0938/0938.pdf

[4] Based on spending between 2003/04 and 2011/12

- The length of the concession. The concession is a variable length concession that will expire when a revenue target is met. Should the projected performance of the crossing either be exceeded or not met the length of the concession could be shorter than forecast or longer than forecast. Under each of these scenarios the accumulated deficit to be recovered through tolling is likely to vary.
- Any change to the level of income received by the Secretary of State regarding the subordinated loan. This could be impacted by the financial performance of SRC in meeting their obligations or through actual inflation differing from forecast inflation which would affect the indexation on the subordinated loan.

The Government has always been clear that it needs to recover the accumulated deficit incurred by UK taxpayers following the end of the concession period. The ability of the Government to continue tolling after the end of the concession is a key part of the Severn Bridges Act 1992 and was made clear during the passage of the legislation.[5] The Department's evidence to the Committee's Inquiry on Severn Crossings tolls in 2010 also noted that there would be debts that would need to be recovered after the end of the concession.[6]

Based on a continuation of the current system and current financial performance the Department expects it to take around 1-2 years to recover the £88m of costs that are projected to fall outside the concession arrangement in 2018. These might therefore be expected to be recovered by 2020. The Department and Highways Agency will continue to monitor the level of accumulated deficit to be recovered through tolling as the end of the concession approaches.

[5] See http://hansard.millbanksystems.com/commons/1991/jan/14/severn-bridges-bill
[6] See http://www.publications.parliament.uk/pa/cm201011/cmselect/cmwelaf/506/506we10.htm
[6] See Severn Bridge Act 1992 Account 2011-12, Income and Expenditure Account p13.

Annex A: Costs falling outside concession agreement and recoverable through tolling under Severn Bridges Act 1992, 1992/93 to 2011/12

Severn Bridges Expenditure - Costs falling outside concession agreement and recoverable through tolling under Severn Bridges Act 1992, 1992/93 to 2011/12 (£000s)

Type	1992-93	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12
Capital	1,742	919	1,583	2,282	(69)	1,623	1,320	1,087	1,719	421	244	642	112	357	22	57	-	8	-	-
Operations	4,267	2,104	3,252	1,641	2,662	2,058	257	170	158	20	173	146	82	682	3,748	4,239	7,049	2,706	3,961	565
Other	1,056	1,035	1,192	669	575	763	586	443	536	562	477	288	362	643	326	454	966	523	342	450