PEVENSEY AND CUCKMERE WATER LEVEL MANAGEMENT BOARD

DRAINAGE RATES

AND SPECIAL LEVIES

CAPITAL FINANCING AND RESERVES POLICY

WATER MANAGEMENT ALLIANCE

Last review date: 31 October 2017 (to be reviewed every 5 years)

Next review date: October 2022

Reviewed by: Pevensey and Cuckmere WLMB

The Capital Financing and Reserves Policy sets out in detail how the Board will finance capital improvement work and asset refurbishment/replacement, and, how it will respond to/recover from emergency events without significantly increasing drainage rates and special levies at the time.

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1. Executive Summary

1.1 The Board's Reserves are inadequate to fund capital improvement work and asset replacement/refurbishment by themselves. Other sources of funding will therefore be needed, access to which cannot be guaranteed.

1.2 Capital improvement work and asset replacement/refurbishment will be financed from a combination of public works loans (subject to a number of conditions), flood defence grant in aid, third party contributions from partners and/or other beneficiaries, the Board's Reserves and from today's ratepayer by way of drainage rates and special levies.

1.3 The Board will seek to collect surface water development contributions and commuted sums from developers and will aim to build up a Development Reserve (net of the expenditure incurred in collecting this income and regulating development) to part fund future improvement work.

1.4 The Board will aim to capitalise and depreciate new and refurbished assets, to spread the cost of capital expenditure over their estimated useful economic life, so as not to over burden today's ratepayer with the full capital cost, when economic benefits will clearly extend into the future.

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2. Capital Financing: Capital Work

2.1 Capital work may be required to increase or sustain the productive capacity of agricultural land and to cope with the additional surface water that arises from the development of land over time, the costs of which are likely to be significant and can run over a number of financial years. Climate change is another important driver, which may lead to the need for improvement work. Capital work may also be required to deliver environmental improvements that have usually been brought about by the introduction of new legislation and/or regulation. Capital work may include the creation of additional on-line and off-line storage or increasing pumping capacity e.g. widening and/or deepening watercourses and building flood storage areas or building new and/or improving/refurbishing existing pumping stations.

2.2 Today the demand for capital improvement work is largely driven by development, new environmental legislation/regulation and from deficiencies that will no doubt be identified in the Board's system from the catchment modelling programme we aspire to undertake in future. Hence it is important that developers contribute towards the cost of this work and pre-fund any additional maintenance liabilities arising therefrom. New burdens that arise from a change in the law must also be fully funded from flood defence grant in aid and/or other grants. This will reduce the impact on drainage ratepayers and constituent billing authorities, in terms of the drainage rates and special levies that are required today and in future.

2.3 Typically much development will take place in a catchment before any capital improvement work is actually required. Hence it is important to collect a fair contribution from each developer up front, so that the work can be paid for in part when it is ultimately needed. The Board will therefore charge developers a rate per impermeable hectare for increasing the flow or volume of water into any of its drainage/flood risk management infrastructure (a surface water development contribution), unless the cost of taking the additional flows is greater. In these circumstances the Board will charge developers the full cost of carrying out improvement works to specifically cater for the additional flows arising from the development. This surface water development contribution/impermeable hectare will be reviewed by the Board periodically.

2.4 Where SuDS are used as an alternative to directly discharging surface water into the drainage network at an un-attenuated rate (now the preferred option), the Board will seek a commuted sum from the developer if it decides to take on the future maintenance liability, and, may also charge a surface water development contribution if the volume/rate of water entering the network is greater as a result of the development.

2.5 The Board will always apply for flood defence grant in aid when economic to do so (both individually and jointly with other Risk Management Authorities, when appropriate) and seek third party contributions from its partners and/or other beneficiaries, to help fund capital improvement work and asset replacement/refurbishment. All grant applications must be approved by the Environment Agency's Area Flood Risk Manager, Project Appraisal Board or Large Projects Review Group (depending on the estimated cost of the project) to access flood defence grant in aid.

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2.6 Drainage ratepayers and constituent billing authorities will aim to collectively contribute as much as possible each year towards the cost of the Board's capital improvement programme, when such a programme has been developed.

2.7 At some point in the future if/when the Board has built up sufficient headroom in its budget, drainage ratepayers and constituent billing authorities may also decide to collectively fund an annual refurbishment provision as part of the rates and levies, which will provide for the future replacement/refurbishment of the key components within existing structures (see section 6 below).

2.8 The Board will consider applying to the Public Works Loan Board for a loan to fund or part fund capital work when the following conditions are met:

2.8.1 When the scheme will deliver a multitude of socio-economic benefits to a number of beneficiaries and a positive cost/benefit ratio arises, and

2.8.2 The economic benefits of the scheme and the asset(s) arising therefrom are expected to extend well into the future for at least the term of the loan, and

2.8.3 There is insufficient flood defence grant in aid or third party contributions from partners and/or other beneficiaries available and there are insufficient Reserves held internally for that purpose, to collectively fully fund the work, and

2.8.4 When permission to borrow money for this purpose has been given by the Secretary of State, as required by section 55(3) of the Land Drainage Act 1991, and

2.8.5 When the Board have approved the scheme in the usual manner and there is sufficient headroom in the budget to service the loan, so as not to pass on unreasonable increases in drainage rates and special levies.

2.9 For example, the Board may decide to apply for a public works loan where capital improvement work is considered necessary prior to any substantive development having taken place in a catchment and there are insufficient funds in reserve and no flood defence grant in aid is available to pay for the improvement work. The scheme cost may, subject to the aforementioned conditions, be financed from a public works loan, with the expectation that this loan will be re-paid from net development contributions and commuted sums (either received from developers directly or possibly via Community Infrastructure Levy), as and when the land benefiting is developed.

2.10 The ability to access most sources of funding will therefore depend on the agreement of others. Hence the importance of maintaining adequate Reserves and of depreciating new, improved and refurbished assets over their estimated economic useful lives, so that the capital cost and the associated benefits are spread fairly over today's and tomorrow's ratepayer.

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3. Capital Financing: Spreading the capital cost of new, improved and refurbished Fixed Assets

3.1 Where new pumping stations, first and second line sluices, water level control structures or other assets are created as part of any capital improvement scheme, the cost of creating these assets (net of any flood defence grant in aid or third party contributions) will be capitalised and depreciated thereafter in accordance with the Board's Financial Regulations and depreciation policy. These assets will be recorded in the Board's Register of Drainage Infrastructure and in the Fixed Assets Register.

3.2 Where a public works loan is used to finance or part finance improvement work the estimated economic useful life of the asset(s) arising therefrom will determine the maximum period over which the loan is to be repaid and the annual depreciation charge will be no less than the annual loan repayments.

3.3 Where the historic costs of existing structures that are owned and recorded in the Board's Register of Drainage Infrastructure are unknown and have not previously been capitalised, each asset will be valued and recorded in the Fixed Assets Register, in accordance with proper practices for smaller authorities set out in the Practitioners' Guide for Smaller Authorities. It is recognised that this is a departure from Generally Accepted Accounting Practice (UK GAAP).

3.4 When existing structures are substantially refurbished or replaced the cost (net of any flood defence grant in aid and third party contributions from partners and/or other beneficiaries, which may be available at the time) will be capitalised and depreciated thereafter in accordance with the Board's Financial Regulations and depreciation policy, subject always to there being sufficient headroom in the budget.

3.5 The cost of purchasing mobile plant will be capitalised and depreciated in accordance with the Board's Financial Regulations and depreciation policy.

3.6 Net profits on disposal of fixed and mobile plant may be transferred to a Plant Reserve at the end of every financial year as and when they arise, in accordance with the Board's Financial Regulations.

4. Capital Financing: Reserves

4.1 The Board should have adequate Reserves to protect drainage ratepayers and constituent billing authorities from significant increases in drainage rates and special levies that would otherwise be needed to fund or part fund future capital work, mobile plant procurement and when responding to/recovering from emergency events.

4.2 It is important that the Board is able to fund or part fund this type of work when it is needed without having to either pass on significant increases in drainage rates and special levies to drainage ratepayers and constituent billing authorities at the time, or leave a legacy of crippling debt for

future generations to cope with. However it is equally important that the Board does not build up unacceptably high levels of Reserve to part fund capital expenditure that may not be needed imminently, at a time when significant cuts are being made to other public services and when the real value of reserves is being eroded by low interest rates and high inflation.

4.3 A balance therefore needs to be achieved when determining an appropriate level of Reserves: between being sufficiently robust financially and therefore able to fund or part fund future capital work and mobile plant procurement when it is needed without significantly increasing drainage rates and special levies at the time, and, taking on too much long term debt in an attempt to minimise what has previously been collected from drainage rate and council tax payers, in terms of Reserves.

4.4 Earmarked Reserves are held (or ring-fenced) for a specific purpose, which form a critical part of the capital financing strategy (for example, a Development Reserve and Plant Reserve). When the Board was constituted on 1 October 2016 it started with nothing and had no Earmarked Reserves and no General Reserve. The Board now has an Earmarked Development Reserve and a General Reserve.

4.5 The Board also has a Revaluation Reserve which records surpluses arising from the revaluation of fixed assets on the balance sheet.

4.6 As a minimum, the Board's Reserves should not fall below one year's expenditure (net of grant), as set out is ADA's Guide to Good Governance (currently £0.55m). Each Reserve is now considered in turn.

5. Earmarked Reserves: Development Reserve

5.1 Surface water development contributions and commuted sums that have been received from developers, net of the expenditure incurred in collecting this income and regulating development, are usually held in a Development Reserve and can then be used to fund or part fund future capital improvement work and any additional maintenance liabilities that the Board may agree to take on arising from such developments.

5.2 These sums are treated as revenue income and, as such, must be shown on the face of the Income and Expenditure Account. At the end of every financial year the Board will review the adequacy of its Development Reserve and consider transferring any operating surpluses from the General Reserve to the Development Reserve, should there be any.

5.3 Commuted sums are also recorded in the Commuted Obligations Register because the receipt of this income places a duty on the Board to maintain the respective infrastructure assets in perpetuity, which is distinctly different from maintaining adopted infrastructure using permissive statutory powers. Hence it is important that the Board is able to identify these obligations today and in future.

5.4 Where the wearing components within existing structures are improved the cost of improvement can also be part funded from a Plant Reserve in addition to replacement/refurbishment (see section 6 below) if/when the Board has sufficient headroom to create such a Reserve.

5.5 It would be unreasonable to expect developers today to pre-fund the full cost of improvement works that are driven by development, when these improvements are also planned to cope with the additional surface water arising from future development and to deliver environmental enhancement and a degree of climate change proofing.

5.6 No development contributions (net of collection costs) were passed over from the Environment Agency to the new Board when it was constituted on 1 October 2016.

6. Earmarked Reserves: Plant Reserve

6.1 When existing structures are refurbished or partially refurbished, be they pumping stations, first/second line sluices or other water level control structures, the cost is likely to be significant. Hence the importance of having a Plant Reserve, which is primarily used to pay for the refurbishment or partial refurbishment of the wearing components within existing structures (net of any capital flood defence grant in aid and third party contributions from partners and/or other beneficiaries, which may be available at the time) to reduce the impact on drainage rates and special levies when relatively large sums are required to fund this work. Specifically this Reserve should be able to fund the refurbishment/replacement or improvement of the following components:

Pumping Stations: Pumps, Switchgear, Telemetry, Weedscreen Cleaners, Fencing and Hand railing.
First Line Tidal Sluices: Sluice Doors/Flap Valves, Switchgear, Telemetry, Fresh Water Sluice Doors, Steel Work Super Structures, Fencing and Hand railing.
Second Line Sluices: Sluice Doors, Flap Valves/Penstocks, and Hand railing.
Water Level Control Structures: Sluice Doors, Flap Valves/Penstocks, and Hand railing.

This Reserve is not intended to fund the refurbishment/replacement of the following components that wear out less frequently. Reliance will therefore be placed on securing flood defence grant in aid and/or public works loans at the time (subject to meeting the aforementioned conditions):

Pumping Stations: Online Structures and Buildings.
First Line Tidal Sluices: Piling, Buildings, Online Inlet Structures, Online Outfall Structures, Box Culvert Pipes or Insitu Concrete.
Second Line Sluices: Piling, Online Inlet Structures, Online Outfall Structures, Box Culvert Pipes or Insitu Concrete.
Water Level Control Structures: Piling, Online Inlet Structures, Online Outfall Structures, Box Culvert Pipes or Insitu Concrete.

6.2 The Plant Reserve is usually financed from an annual refurbishment provision which is charged to drainage ratepayers and constituent billing authorities every year, as part of the drainage rates and

special levies calculation. Operating surpluses are then transferred from the General Reserve to the Plant Reserve at the end of the financial year. However the Board is not currently in a position to do this because it does not have sufficient headroom in its revenue budget. This position will be reviewed annually.

6.3 If/when the Board is ever able to create such a Reserve its adequacy and the annual refurbishment provision will be reviewed at the end of every financial year by profiling the refurbishment work of the wearing components noted above that are required for each structure over their remaining economic useful life and estimating the likely cost of doing this work at the time, using present day values. From this we will then estimate the present day refurbishment requirement of the wearing components for each structure, together with the cumulative and annual refurbishment requirement for each structure. We can then establish the amount the Board should hold in Reserve (the cumulative refurbishment requirement) and compare this to the provision which is actually held in the Plant Reserve at the end of the financial year. The two figures should be similar and the adequacy of this Reserve is expressed as a proportion of the cumulative refurbishment requirement. This position should be monitored annually.

6.4 There is always going to be a difference (or deficit) between what is held in reserve and the present day total estimated refurbishment requirement, as it would be both unrealistic and unreasonable to expect the Board to hold all of the funds required to refurbish the wearing components within existing structures in reserve. This is because these assets will not all need refurbishing at the same time and the economic benefits of asset refurbishment will usually extend well into the future, so the cost should therefore be capitalised and depreciated over the asset's estimated economic useful life. Significant asset refurbishment will also usually include a degree of improvement, which should be more likely to attract flood defence grant in aid and other funding.

6.5 This Reserve currently stands at zero – nothing was passed over from the Environment Agency to the new Board when it was constituted on 1 October 2016.

7. General Reserve

7.1 Responding to and recovering from emergency events can be very expensive and it is important that the Board has the means to fulfil its role as a de-facto 'Category 2 Responder' in emergency situations and is able to promptly instigate recovery/reinstatement work to its own infrastructure following an event.

7.2 The extent of the Board's role and how it will respond in an emergency is set out in the Emergency Plan. Such responses and recovery operations will be financed or part financed from the General Reserve, however it is envisaged that national funding will be provided to assist in the recovery phase following any significant emergency event, but there are no guarantees.

7.3 As a general rule of thumb an IDBs level of General Reserve should aim to be no less than 20% of net expenditure to finance responding to/recovering from emergencies, resolving legacy issues which

may emerge from time to time when appropriate and addressing any contingent liabilities. The Board should therefore aim to build a General Reserve of circa £62.5k over the next 10 years.

7.4 If national funding is not provided to assist in the recovery phase following a significant emergency event, the Board may need to consider taking out a public works loan to fund the reinstatement work. If this situation ever arises the Board will apply for consent from the Secretary of State at the time to borrow the money to fund this work, as required by section 55(3) of the Land Drainage Act 1991.

7.5 The General Reserve of £22.2k as at 31 March 2017 is inadequate - nothing was passed over from the Environment Agency to the new Board when it was constituted, however a cash transfer sum is expected sometime in future.

8. Other Reserves: Revaluation Reserve

8.1 The purpose of this Reserve is to record surpluses arising from the revaluation of fixed assets on the balance sheet.

8.2 The Board owns 6 pumping stations and these have been valued in the manner set out in the Practitioners' Guide for Smaller Authorities 2017.

8.3 These assets were transferred from the Environment Agency when the Board was constituted on 1 October 2016 at zero cost, and have been included in the Fixed Assets Register with a nominal value of one pound (£1) each, as a proxy for the zero cost.

8.4 It is recognised that this is a departure from Generally Accepted Accounting Practice (UK GAAP), but is in accordance with proper practices for smaller authorities as set out in the Practitioners' Guide for Smaller Authorities 2017.

9. Governance, Transparency and Assurance

9.1 The Board will always carry out the necessary preliminary investigations and appropriate project appraisals prior to approving any major capital improvement scheme, to ensure that ratepayers are getting the best solution and value for money, and, that the affected land occupiers are all consulted.

9.2 Each year the Board's Chairman's Committee scrutinises the proposed works programmes, as drafted by the Engineer.

9.3 The Board monitors delivery of the works programmes, and, provides guidance and support to the Engineer and Operations Manager.

9.4 The Board's Engineer is responsible for drafting the works programmes, as set out in the Financial Regulations. The Board's Operations Manager is responsible to the Engineer for delivering and procuring the maintenance programme, as set out in the Financial Regulations.

9.5 During the next 3 years the Board will develop a 5 Year Indicative Forecast, which shows how capital improvement, asset replacement/refurbishment and mobile plant procurement will be financed from Drainage Rates and Special Levies, after taking into account all other anticipated sources of funding. This 5 Year Indicative Forecast will then be reviewed and approved by the Board every year, as part of the annual budgeting/rate setting process.

9.6 The Board has an Investment Policy which sets out how it will safeguard and invest cash surpluses.

9.7 The Rate Budget, Works Programmes and Investment Policy are all published on the Board's website.

9.8 The works programmes are independently quality assured (ISO 9001 and ISO 14001). The Internal Auditor will also periodically assess whether the Board has proper arrangements in place to secure economy, efficiency and effectiveness in its use of resources. The Internal Auditor's Report is considered by the Board and published on its website every year.

9.9 All sources of capital financing are included and reported in the Board's audited Annual Accounts each year. The External Auditor is appointed independently and provides an opinion on whether the Annual Accounts have been prepared in accordance with proper practices for smaller public bodies. The External Auditor's opinion and general observations are published on the Board's website every year.

10. Certification

The Board has approved this Policy on 31 October 2017.

By Order of Pevensey and Cuckmere Water Level Management Board

Certified by Mr P J Camamile, Chief Executive

31 October 2017