SOUTH HOLLAND INTERNAL DRAINAGE BOARD

DRAINAGE RATES

AND SPECIAL LEVIES

CAPITAL FINANCING AND RESERVES POLICY

WATER MANAGEMENT ALLIANCE

Last review date: 11 February 2020 (to be reviewed every 5 years)

Next review date: February 2025

Reviewed by: South Holland IDB

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 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.

1.5 The Pensions Reserve deficit and the Consortium's shared Pensions Reserve deficit may seriously impact on the Board's ability to operate as a going concern, if it continues to increase as fast as it has been doing. The Board will continue to work closely with the administering authorities to reduce these deficits and minimise the increases in pension contributions that will be required in 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 have been identified in the Board's system from the catchment modelling programme. 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 needed. The Board will therefore continue to 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, 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 development contribution if the volume of water entering the network is greater as a result of the development. All additional maintenance liabilities that may arise directly from development will be pre-funded from commuted sums, in accordance with the Board's Planning/Byelaw Policy. The Board will review its position if/when the LLFAs SAB is established under the Flood and Water Management Act 2010 or when it becomes clear as to what (if any) other funding will come from the CIL introduced via the Localism Act 2011.

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.

2.6 Drainage ratepayers and constituent billing authorities will aim to collectively contribute towards the cost of the Board's capital improvement programme (Revenue Contribution to Capital Outlay).

2.7 Drainage ratepayers and constituent billing authorities will also aim to collectively fund an annual refurbishment provision, 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 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 Earmarked 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 unacceptable 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 via the SAB and/or CIL), 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 have not previously been capitalised and shown in the Fixed Assets Register, or, where the pumping stations have been re-valued and capitalised as at 31 March 2010 on the advice of the External Auditor, each structure will be re-valued in accordance with proper practices as set out in the Practitioners Guide for Smaller Authorities. It is recognised that this is a departure from standard accounting practice.

3.4 When existing structures are refurbished or partially refurbished the cost of refurbishment (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 continue to be capitalised and depreciated in accordance with the Board's Financial Regulations, Depreciation Policy and Plant Replacement Policy.

3.6 Net profits on disposal of fixed and mobile plant may be transferred to the Fixed 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's Reserves exist 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 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 cash 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 capital work and mobile plant replacement 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 The Board has a number of Earmarked Reserves that are each held (or ring-fenced) for a specific purpose, which form a critical part of the capital financing strategy (Development Reserve, Plant Reserve and Capital Works Reserve). Reliance on these Reserves and other sources of capital is demonstrated by the significant difference between the gross cost of capital improvement works and the revenue contribution to capital outlay, as shown in the five year capital programme.

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 The Earmarked Reserves and General Reserve should also be sufficient for the Board to be able to continue as a going concern after netting-off the bulk of its Pensions Reserve deficit, which is calculated annually by Lincolnshire County Council's Pension Fund Actuary and after netting-off its share of the Consortium's Pension Reserve deficit. 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 £3.25m).

4.7 Each Reserve is now considered in turn.

5. Earmarked Reserves: Development Reserve

5.1 Development contributions and commuted sums that have been collected from developers net of the expenditure incurred in collecting this income and regulating development are usually held in a Development Reserve and can 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. However, 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.

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. 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 will also be part funded from the Fixed Plant Reserve, in addition to replacement/refurbishment (see section 6 below).

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.

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 financed from approved transfers that may come from the General Reserve at the end of every financial year.

6.3 The adequacy of this Reserve and the annual refurbishment provision is 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 have estimated the present day refurbishment requirement of the wearing components for each structure, together with the cumulative and annual refurbishment requirement for each structure. We have then established the amount the Board should hold in Reserve (the cumulative refurbishment requirement) and compared 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 will continue to 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.

7. Earmarked Reserves: Capital Works Reserve

7.1 The purpose of the Capital Works Reserve is to ensure that there are sufficient resources in place to part fund previously agreed capital improvement and asset replacement/refurbishment work that takes longer than planned to deliver. Ideally this Reserve should be zero because capital work would always be delivered in the year that it was planned; however this is often unrealistic for a number of reasons, such as the weather.

7.2 This Reserve should generally remain static or reduce from year to year. If it continues to build year-on-year then this would indicate that the capital programme is either overly reliant on flood defence grant in aid to deliver, given that the availability of grant can disappear at the drop of a hat and therefore prevent planned work from happening, or that the programme is too ambitious, given the technical support resources that are available to the Board.

7.3 When capital work is not completed in the financial year that it is planned, the difference between what has been budgeted for those schemes that are being funded or part funded from drainage rates and special levies, and what has been expended on those schemes is transferred from the General Reserve to the Capital Works Reserve at the end of the financial year. Funds from the Capital Works Reserve are then applied to the General Reserve as and when the planned capital improvement work is delivered. When such schemes have been completed, any under spend is then removed from the Capital Works Reserve and reapplied to the General Reserve at the end of the financial year.

7.4 This Reserve is considered to be adequate to fund or part fund capital work that has previously been approved by the Board, but not yet delivered. This position will continue to be monitored annually.

8. General Reserve

8.1 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 'Category 2 Responder' in emergency situations and is able to promptly instigate recovery/reinstatement work to its own infrastructure following an event.

8.2 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.

8.3 As a general rule of thumb the Board's level of General Reserve should aim to be between 20% and 25% 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 will therefore aim to maintain a General Reserve of no less than £600k at the end of every financial year.

8.4 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.

8.5 The General Reserve is considered to be adequate, in conjunction with the Board's insurances. This position will continue to be monitored annually.

9. Other Reserves: Pensions Reserve

9.1 The purpose of this Reserve is to fund the Board's pension liabilities for current, former and future employees. This Reserve is calculated by the County's Local Government Pension Scheme (LGPS) Fund Actuary at the end of every financial year for accounting purposes, so that it is included in the Board's Year-End Financial Statements. A note of the total WMAs Pensions Reserve deficit is also included in the Board's Year-End Financial Statements, for which the Board is liable for its share.

9.2 This Reserve is in deficit which means that the Board has not been contributing enough to fund the Actuary's assessment of pension commitments as at the balance sheet date. However this assessment can change significantly from year to year, depending on investment performance, mortality rates and on the number/age profile of active members that the Board employs etc. It does not therefore represent the exit cost of closing down or withdrawing from the LGPS as at the balance sheet date, the cost of which is likely to be much greater than the Pensions Reserve deficit.

9.3 The government has changed the LGPS from a Final Salary Pension Scheme to a Career Average Pension Scheme, to reduce the rate at which the deficit increases in future (with effect from 1 April 2014). However the rising Pensions Reserve deficit has now led to the administering authority requesting deficit recovery payments from the Board which have been determined by the Fund Actuary and are likely to continue for at least the next 20 years.

9.4 The deficit recovery payments are substantially beyond the Board's ability to control. However the Board is doing all that it can within its control to tackle the deficit by adopting the model discretionary policies as recommended by the administering authority, which will not by themselves cause the deficit to increase. The scheme also remains open to new entrants. If this was not the case, the deficit recovery payments being requested would be considerably greater.

9.5 The Pensions Reserve deficit is likely to increase over the next 20 years unless the number of employees in the scheme increases significantly, the maturity profile of employees gets younger and the number of pensioners reduces, or the Board increases the deficit recovery payments it makes to the administering authority. All scenarios would lead to increases in drainage rates and special levies.

9.6 Clearly the Pensions Reserve deficit may seriously affect the Board's ability to operate as a going concern if it continues to increase. Therefore it is vitally important that the Board work closely with the administering authority to avoid explosive increases in drainage rates and special levies being required to reduce the deficit and that the Board's Earmarked Reserves are maintained at a sufficient level to substantially offset the Pensions Reserve deficit. This position will continue to be monitored annually (and triennially when the Fund Actuary formally re-values the fund).

10. Other Reserves: Revaluation Reserve

10.1 The purpose of this Reserve is to record surpluses arising from the revaluation of fixed assets on the balance sheet. The Board has previously re-valued its Office and Workshop site and its Pumping Stations on the advice of the External Auditor, where reliable historic cost information was not available. However the Board now has more flexibility when accounting for fixed assets, following implementation of the Audit and Accounts Regulations 2011.

10.2 The residual values of all pumping stations will therefore be removed from this Reserve because they have no market value, other than scrap value. However the Office and Workshop site does have a market value and will therefore be re-valued accordingly, with the adjustment in value being reflected in the Revaluation Reserve at that time.

10.3 This Reserve will therefore only aim to reflect the market value of the Board's Office and Workshop site. This asset class will be re-valued every 5 years.

11. Governance, Transparency and Assurance

11.1 The Board 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.

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11.2 Each year the Board's Plant & Development Committee scrutinises the proposed capex programmes, as drafted by the Catchment Engineer and Operations Manager and makes recommendations to the Board accordingly.

11.3 The Board monitors delivery of the capex programmes, and, provides guidance and support to the Catchment Engineer and Operations Manager.

11.4 The Board's Catchment Engineer is responsible for designing, delivering and procuring the capital improvement and asset refurbishment programmes, as set out in the Financial Regulations. The Board's Operations Manager is responsible to the Catchment Engineer for designing, delivering and procuring the mobile plant replacement programme and the maintenance programme, as set out in the Financial Regulations.

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

11.6 The Board has an Investment Policy which sets out how it will safeguard and invest cash surpluses included in the Reserves.

11.7 The Rate Estimates, 5 Year Indicative Forecast, Works Programmes and Investment Policy are all published on the Group's website.

11.8 The capex programmes are independently quality assured (ISO 9001 and ISO 14001). The Internal Auditor also assesses 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 published on the Group's website every year.

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

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12. Certification

The Board has approved this Capital Financing and Reserves Policy on 11 February 2020.

By Order of South Holland Internal Drainage Board

Certified by Mr P J Camamile, Chief Executive

11 February 2020