

HAMPSHIRE COUNTY COUNCIL

Report

Committee	River Hamble Management Committee
Date:	20 December 2024
Title:	Review of Asset Replacement Reserve Policy
Report From:	Director of Universal Services

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Purpose of this Report

1. The purpose of this report is to present recommendations resulting from a routine and general review of Asset Replacement Reserve (ARR) policy.
2. Recommendations propose the adoption of a reasonable planning method to consider inflation in a specialised market where rates may differ from normative retail indices. They also propose reasonable assumptions against which the Reserve may need to perform in relation to disruptive challenges.

Recommendations

3. That the River Hamble Management Committee recommends that the River Hamble Harbour Board:
 - a) Agrees that the minimum holding level of the Reserve, currently forecast to fall in 2035, is reviewed annually and formally each April, taking into account a best assessment of likely inflationary pressures, to ensure that the principal of an adequate reserve level is sustained. This statement acknowledges that the current £100,000 figure is broadly correct, when adjusted for inflation;
 - b) Notes the general impact of compound inflation on the Reserve in a marine sector which may be higher than normative RPI figures;
 - c) Agrees that reasonable planning assumptions are adopted for scale and concurrency of 'force majeure' disruptive challenges and that these should sit at a minimum of £22,000 (2024 rates), that figure being catered for within the existing minimum holding policy.

Executive Summary

4. The Asset Replacement Reserve (ARR) is the Harbour Authority's capital reserve maintained by annual agreed contributions from revenue. It services higher value operational assets essential to sustaining the statutory functions, duties and obligations of the RHHA.
5. The level at which the ARR is maintained is important to the Duty Holder who requires assurance that the Harbour Authority will have sufficient long-term capital to remain compliant with requirements of the Port Marine Safety Code.
6. The Reserve is routinely subject to annually assessed changes in contributions from revenue. The Asset Review report in the April meeting is used to adjust the level of these to meet predicted requirements. Why those requirements are set is the subject of this review. There is no imminent concern over future levels at this stage; the intent here is a prudent review aimed at the continuous improvement of ARR policy to minimise risk.
7. A reasonable assessment is made of the compound impact of inflation and also the possibility of a 'disruptive challenge' on the finances of the ARR to ensure that the reserve is held at an adequate level.

Background

8. The Asset Replacement Reserve (ARR) is one of three Reserves maintained by the River Hamble Harbour Authority (RHHA). Its purpose is to sustain items of the RHHA's physical infrastructure, essential to the delivery of its duties, functions and obligations as the Harbour Authority. The condition of the ARR is reviewed routinely and formally at the April Board Meeting round. There is no current concern at its holding level. This is a general policy review.
9. ARR policy has been refined over time. From 2011 until three years ago, Board policy remained unchanged with £35,000 being set aside from revenue annually. There was no minimum holding policy. An assessment of assets' condition and the likely future cost of repair and replacement was made each year. Recognition of the need for continuous improvement, and volatility in manufacturing and material costs brought about by events such as Brexit, COVID and the Russian invasion of Ukraine led to a first policy review in 2022.
10. That review led to an increase in the annual revenue contribution to the ARR to £42,000 and the setting of a minimum holding at the Reserve's forecast lowest holding point in 2035 of £100,000 as a prudent step to guard against market volatility. To achieve this, the likelihood of further need for outline

increases in 2026 (to £46,000) and in 2030 (to £50,000) was advertised to take account of likely future inflationary pressures. These programmed increases are included in the current reserve forecasts. Interest is also earned on the balance of the Reserve although at levels which are dependent on variable Base Rates. Following pre-emptive investments in long-life patrol craft and an early bridge repair, the current minimum holding in 2035 is currently predicted to be £161,000.

11. This figure places the ARR in a strong position against current policy requirements. At face value, it obviates the requirement for increases (beyond those advertised) in the contribution from revenue and associated (albeit minor) increases in Harbour Dues. However, niche marine material and manufacturing inflation is routinely in excess of the retail price index. Separately, current service sector inflation is 5.7%. Consideration of what £161,000 might be worth in 2035 as well as the purchasing power of £100,000 (the current minimum holding policy) is important.
12. Assuming a steady 2% annual level of inflation, £161,000 today will be worth £131,500 in 2035. Adopting the higher current service sector inflation level of 5.7%, would make it worth £89,900. Inflation levels will not be so smooth but this does indicate how the value of £161,000 might reduce. How inflation levels will affect the purchasing power of the ARR over time is equally difficult to determine. However, the ability of the Board to make annual (if necessary) upward adjustments to cope with inflation already exists and increases in the level of our revenue contribution aim to cater for that. It is worth noting that the purchasing power of £100,000, our current minimum holding policy, if maintained, will be around £81,700 at today's rates with 2% inflation or £55,800 with 5.7% inflation.
13. As well as acting as a buffer against unpredictability in inflation, the minimum holding of the ARR should also be able to cater reasonably with accepted if unexpected 'disruptive challenges'. This follows practice set out in Cabinet Office contingency planning principles. These challenges should also inform our capital holding requirements.
14. For the Harbour Authority, a 'disruptive challenge' will be an event or circumstance that disrupts and damages operational capability within the River. Challenges can be the result of natural events such as the impact of weather or which may have occurred through human intervention or action. In the latter case, damage to harbour authority operational capability (patrol craft or jetty or pontoon facility) caused by third-party craft (large and or commercial) will generally be recoverable. The likelihood of this type of event occurring and not being witnessed is considered minimal, firstly, because there is no such event on record and, second, because the nature of the traffic capable of causing such damage means that it is authorised to operate in tightly controlled circumstances and during operational daylight hours only. Weather related damage to assets is considered possible, given the

Harbour's unique exposure (within the Solent) to the prevailing South-westerly airstream. Here, wind speeds of 70 knots have been recorded at the Harbour Office and some Harbour Authority facilities are, albeit rarely, exposed to these conditions. It is also recognised that surge tides within the River can cause a strong ebb which, when coincident with storm force winds, can lead to localised, rough and damaging 'wind-over-tide' sea states in the lower River. These 'acts of God' type scenarios are those the Harbour Authority must be prepared for.

15. With few exceptions, Harbour Authority facilities sit in the lower River where exposure to the strongest South-westerly weather conditions is most likely. Parts of the Warsash and the midstream facilities can be most exposed to the worst of our weather conditions and can therefore be most susceptible to damage. Both facilities are 'composite', being made up of multiple pontooned and piled supporting arrangements. The piles and pontoons are mutually supportive and designed to be resilient to the effects of the prevailing conditions. Additionally, developments in pontoon technology mean that stronger pontoon construction is becoming available. Harbour Authority investment in 'wave-breaking' pontoons at the most exposed Fishermens' Jetty has proved effective in mitigating risk. Not only are these pontoons stronger in terms of construction and much less susceptible to damage from wind-over-tide effects – the most likely cause of a disruptive challenge – but they also provide some useful shelter as a breakwater to the remainder of the Warsash facility upstream. This type of pontoon will be considered when future replacement is required. All this means that it is considered highly unlikely that each entire facility will fail 'wholesale'. Instead, a more reasonable assumption is that a single section or 2 sections of exposed pontoon may be subject to terminal damage. It is this assumption that the Board is asked to accept as the most reasonable eventuality against which an unplanned draw on the Asset Replacement Reserve may, in extremis, be reasonably required.
16. The acceptance of this type of damage as a reasonable worst-likely-case assumption will be an additional consideration of any need for adjustment in the minimum holding of the ARR. To date, no damage to Harbour Authority facilities has taken place which has required an unplanned draw on the Reserve. However, while the eventuality is an unlikely one, it is for the Board to be content that the risk is not only managed reasonably but also, that overly excessive amounts of capital are not set aside for events that have no reasonable chance of happening. The Board is always mindful of the impact of concomitant unnecessarily high contributions to the ARR on Harbour Dues paid by River Users.
17. For cost illustration purposes, the length of a standard RHHA pontoon is considered to be 11.5m. The cost of each linear metre of replacement pontoon is currently around £750. Each section of pontoon can therefore be nominally rated at around £8600 (ex VAT). Delivery, fitting and disposal of old pontoons mean that £10000 (ex VAT) is a reasonable figure currently for

each section's exchange. Replacement of two sections in the event of unforeseen damage might therefore be expected to cost around £20000. It is this figure which is proposed as being reasonable to have in mind when considering ARR holdings to meet a disruptive challenge.

Further Analysis

18. Serviced by contributions from Revenue, ARR holdings are, in addition to current and future budgetary pressures (additional employers' National Insurance Contributions, salary increases, increased pension contributions, for example), influences on the setting of Harbour Dues. Current contribution from Revenue is agreed each Spring and is, at the time of writing, set at £42,000. Approximate increases in the level of annual contribution to £46,000 in 2026 and to £50,000 in 2030 have been advertised. These increases are incorporated in our future budget for the Reserve. The impact on Harbour Dues in each respective year requiring an increase is low in comparison to the long-term benefit to the capital holding of the Reserve. Each £4,000 increase in the contribution requires approximately a relatively modest 0.8% increase in Harbour Dues.
19. The current forecast minimum holding of the ARR in 2035 is £161,000. While this figure exceeds the current policy by £61,000 at today's rates, the impact of inflation will reduce the real value by an unknown margin. While impossible to determine exactly how inflation might affect the holding, a reasonable attempt might be made. Current RPI figures (2024) are 2.7%. Were these to be applied in a compound manner, £161,000 would be worth around £116,000 of today's money in 2035. Accepting that inflation in a niche market might be higher, at 4%, £161,000 would be worth £100,000 and at 5%, £89,000.

Conclusions

20. Current Asset Replacement Reserve policy, namely to maintain a 'safety net' of around £100,000 at the minimum holding point, currently forecast to be in 2035, is broadly correct.
21. Inflation will reduce the value of £100,000 in 2035 and consideration should be given each year to raising that minimum amount to offset the impact of inflation.
22. Inflation in niche maritime markets can (and frequently does) exceed ONS RPI figures of 2.7% (2024). It will be important to strike a reasonable balance on inflationary planning so as not to overly contribute to capital reserves.

23. The Asset Replacement Reserve balance should be maintained with the need to cater for certain adopted 'disruptive challenges' in mind. Those challenges are not judged to be excessively large and will be catered for by maintaining the minimum (at current rates) Reserve balance of £100,000.

Recommendations

24. That the minimum holding of the Reserve, currently in 2035, is reviewed annually and formally each April, taking into account a best assessment of likely inflationary pressures, to ensure that the principal of an adequate reserve level is sustained. This statement acknowledges that the current £100,000 figure is broadly correct, when adjusted for inflation.
25. That the Board notes that niche inflation rates in the marine economy may vary from normative rates and that this may have a bearing on necessary levels of contribution.
26. That the Board notes that 'disruptive challenges' may be faced. These are, by definition unpredictable. However, the Board is asked to agree that a minimum policy holding for that purpose of £22,000 at 2024 rates be adopted, this figure being exceeded by the minimum holding figure of £100,000.

REQUIRED CORPORATE AND LEGAL INFORMATION:

Links to the Strategic Plan

Hampshire maintains strong and sustainable economic growth and prosperity:	Yes
People in Hampshire live safe, healthy and independent lives:	Yes
People in Hampshire enjoy a rich and diverse environment:	Yes
People in Hampshire enjoy being part of strong, inclusive communities:	Yes

Section 100 D - Local Government Act 1972 - background documents

The following documents discuss facts or matters on which this report, or an important part of it, is based and have been relied upon to a material extent in the preparation of this report. (NB: the list excludes published works and any documents which disclose exempt or confidential information as defined in the Act.)

Document

Location

None

EQUALITIES IMPACT ASSESSMENT:

1. Equality Duty

The County Council has a duty under Section 149 of the Equality Act 2010 ('the Act') to have due regard in the exercise of its functions to the need to:

- Eliminate discrimination, harassment and victimisation and any other conduct prohibited by or under the Act with regard to the protected characteristics as set out in section 4 of the Act (age, disability, gender reassignment, marriage and civil partnership, pregnancy and maternity, race, religion or belief, sex and sexual orientation);
- Advance equality of opportunity between persons who share a relevant protected characteristic within section 149(7) of the Act (age, disability, gender reassignment, pregnancy and maternity, race, religion or belief, sex and sexual orientation) and those who do not share it;
- Foster good relations between persons who share a relevant protected characteristic within section 149(7) of the Act (see above) and persons who do not share it.

Due regard in this context involves having due regard in particular to:

- The need to remove or minimise disadvantages suffered by persons sharing a relevant protected characteristic that are connected to that characteristic;
- Take steps to meet the needs of persons sharing a relevant protected characteristic that are different from the needs of persons who do not share it;
- Encourage persons sharing a relevant protected characteristic to participate in public life or in any other activity in which participation by such persons is disproportionately low.

2. Equalities Impact Assessment:

An EIA is not required as no negative impacts are anticipated.