# PART E – THE ECONOMIC CONTEXT

# 10. The Economic Context

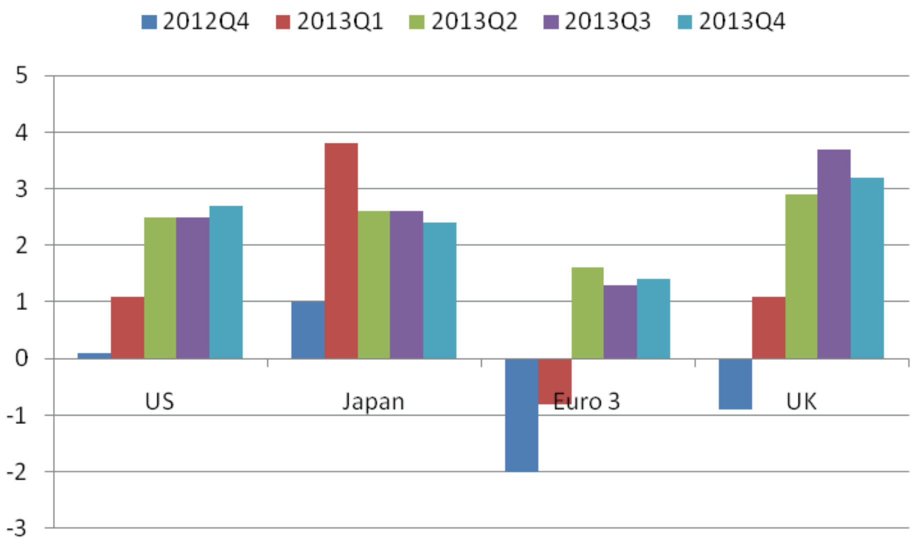
## Global outlook

There have been some positive economic developments at the global level in recent months. The OECD has stated that "the pace of recovery in the major advanced economies improved in the second quarter" and that "activity is expanding at encouraging rates in North America, Japan and the United Kingdom, while the euro area as a whole is no longer in recession." However, they also note that growth has slowed in several emerging economies. They conclude that while recent improvements are welcome "a sustainable recovery is not yet firmly established and important risks remain".

The OECD expect that the improvements in growth seen in the first half of 2013 will be maintained for the rest of the year. The chart below shows that higher GDP growth rates will be maintained for the remainder of the year.

### FIGURE 18 – GROWTH TRENDS IN THE KEY ECONOMIES

annnualised % change in real GDP




Euro 3 = weighted average of Germany, France and Italy

Source: OECD Interim Economic Assessment, September 2013

The OECD emphasises that risks remain high. Namely:

- The euro area remains vulnerable to renewed financial, banking and sovereign debt tensions.
- Uncertainty about the fiscal outlook and the potential withdrawal of quantitative easing clouds the outlook for the US.
- Further financial market volatility could continue to act as a drag on emerging markets.

The OECD policy advice at the global level is to continue to support demand in order to reduce the risk that the recovery will be derailed.

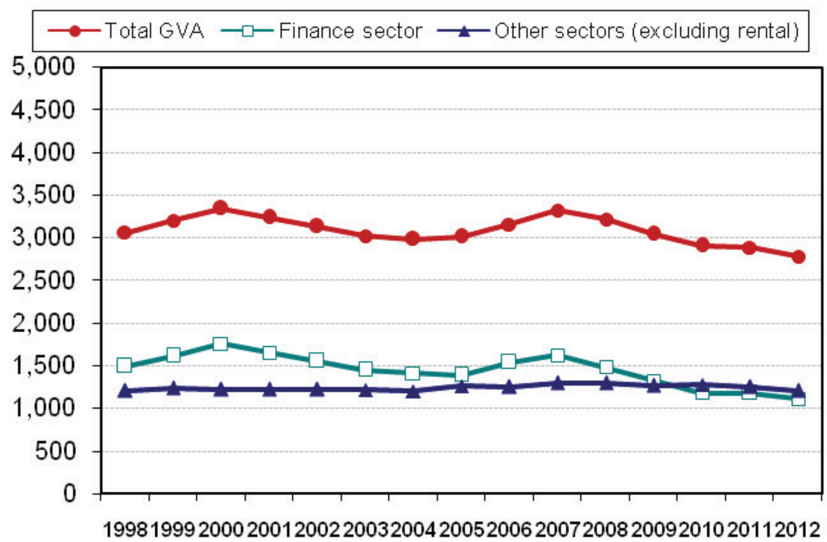
In the UK, the Bank of England has stated that a recovery appears to be taking place but that it will remain weak given the continuing post financial crisis process of adjustment and repair. With this in mind and under the stewardship of the new Governor Mark Carney, the Monetary Policy Committee has adopted a new approach to monetary policy, providing explicit guidance regarding the future conduct of monetary policy. That is, that it intends “at a minimum to maintain the present highly stimulative stance of monetary policy until economic slack has been substantially reduced, provided this does not entail material risks to price stability or financial stability”. A key consideration will be the unemployment rate and whether it has fallen below 7%.

## Jersey trends

In 2012, economic activity in Jersey fell by 4 per cent in real terms, representing the fifth consecutive annual fall. Although the rate of decline was slightly faster than 2011 it was only just outside the forecast of the FPP that growth would be in the region of 1 to -3% last year. The overall fall was a result of declines of -5% for the financial services sector and -4% for the non-finance sectors. Although GVA per capital fell in Jersey in 2012 to £36,700 it was about two-thirds greater than that in the UK of £21,900.

FIGURE 19 – TRENDS IN JERSEY ECONOMIC ACTIVITY

real GVA 2003 prices, £m

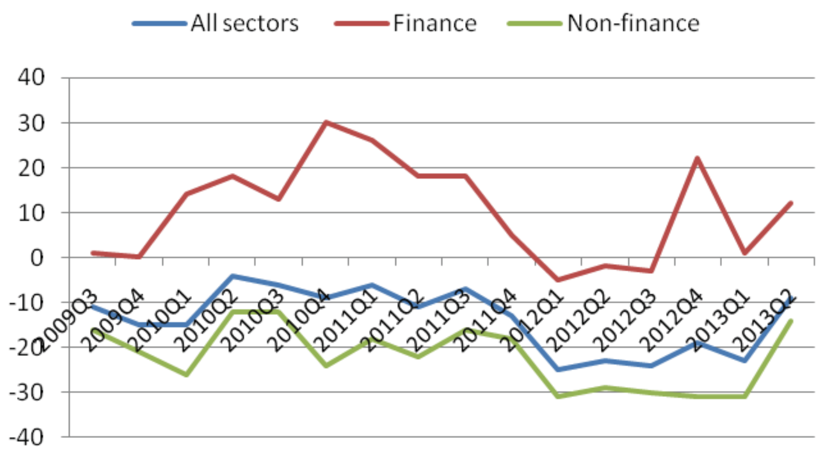



Source: States of Jersey Statistics Unit

The latest survey information for the second quarter of 2013 shows that firms report business activity is improving in the finance sector and that while it remains negative for non-finance sector, it is the least negative since September 2010 (see chart below). The headline business activity indicator remains negative in 2013Q2 but it is the least negative since September 2011. Five of the ten indicators for the finance sector improved and 7 of the 10 indicators for the non-finance sector also improved in the second quarter (although all remained negative in the non-finance sector).

## FIGURE 20 – LATEST TRENDS IN ECONOMIC ACTIVITY

% balance of respondents, business activity indicator

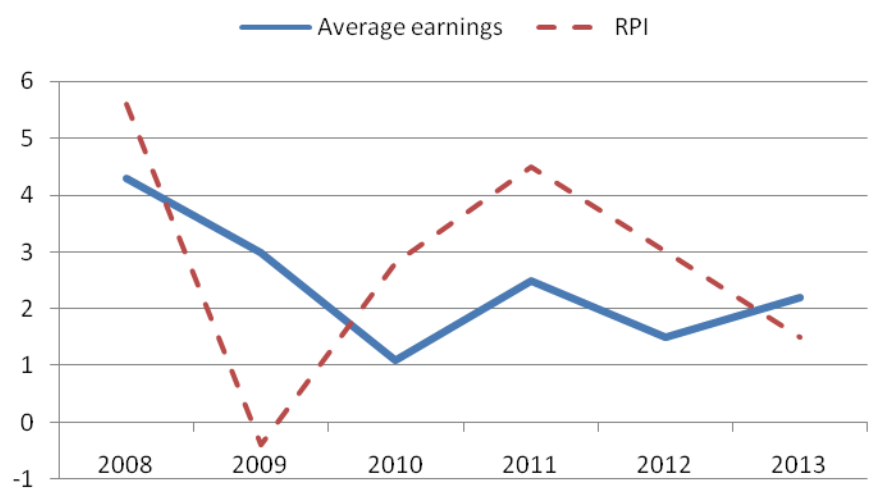



Source: States of Jersey Statistics Unit

Recent labour market data for Jersey has been more positive. In particular, real earnings have increased for the first time in four years (see chart below). Average earnings growth in June 2013 was 2.2%, 0.7% higher than in June 2012 and also than inflation. This is an early indication that economic trends in 2013 have changed significantly relative to those in 2012 when average earnings growth was 1.5% less than RPI. However, unemployment reached a peak in early 2013 and has since remained stubbornly high. Whilst 2012 saw total employment fall slightly from the record highs of 2011, the overall figure masks an increase in part-time employment at the expense of full-time employment.

## FIGURE 21 – EARNINGS AND INFLATION

% change in average earnings and RPI, June each year




Source: States of Jersey Statistics Unit

## Fiscal Policy Panel

The Fiscal Policy Panel (FPP) in their 2012 annual report (published in October 2012) forecast further declines in GVA in both 2012 and 2013 – of between 1 per cent and 3 per cent – with risks remaining to the downside. This represented a downgrade from their previous forecast, on the basis of the continued deterioration in the economic situation within the Island and externally, and sluggish demand as a result of fiscal constraints in many of the advanced economies.

The FPP provide important independent advice for the planning of our finances. Each year they publish an annual report containing an updated economic outlook for Jersey and advice to help with fiscal planning. Their next report is due to be published in early November.

Last year, in the context of a slightly downgraded economic outlook for Jersey in 2012 and 2013, the FPP highlighted seven key recommendations:

1. *The Panel's assessment of the economic outlook for the Jersey economy has been downgraded for 2012 and 2013 and there are indications that significant spare capacity will remain in the economy over this period. This leads the Panel to advise that the States should act now to give discretionary fiscal support to the economy in 2012 and 2013 and if practical to a greater extent than set out in the MTFP.*

2. *While the consideration of additional discretionary stimulus should not be limited purely to capital expenditure it is clear that with such significant capital allocations over the life of the MTFP consideration could be given as to whether, in a timely, temporary and targeted manner:*

    - *capital allocations in 2012 and 2013 can be spent in the year of allocation;*

    - *capital allocations from 2014 and 2015 can be brought forward to 2012 and 2013; and*

    - *unspent allocations in 2012 from previous years can be spent as quickly as possible in late 2012 and 2013.*

3. *The extent of stimulus should not be limited by the balances on the Consolidated or Stabilisation Funds. The States should give consideration as to the best way to fund needed stimulus if it is constrained by the availability of funding from these sources, not least because any constraint would be one of cash flow and funds could be repaid from future revenue.*

4. *It is too early to judge whether the stimulus that will be provided to the economy in 2014 and 2015 by capital expenditure financed by one-off receipts will be warranted but contingency plans should be made as to what measures could be implemented to reduce the extent of the stimulus if economic conditions merit such an approach.*

5. *No transfers into the Stabilisation Fund are recommended in 2012 or 2013. However, further consideration needs to be given as to how the Stabilisation Fund will be rebuilt through countercyclical fiscal policy, once the economy begins to recover. The Panel does not recommend a transfer into or out of the Strategic Reserve at this stage.*

6. *The Panel cannot rule out that there is an underlying structural imbalance between expenditure and revenue. The Panel's view is that further analysis is required by the Treasury and Resources Department to consider the nature of proposed capital expenditure, the way it is funded and what it implies for the underlying position of States' finances. If this analysis suggests there is a structural deficit then consideration should be given to its extent and nature, including a more detailed plan of action to rectify it.*

7. *The Panel have had to make significant adjustments to the financial forecasts presented in the MTFP to try to assess the underlying economic impact of the proposals. In future the presentation of States' finances would be more informative, leading to a better informed policy debate, if these types of adjustments were already included in the analysis accompanying any proposals in the MTFP or Budget.*

## The 2014 Budget

This Budget is framed against the international backdrop, local economic developments and the advice of the FPP. It supports our key economic objectives of supporting the economy in the short-term through fiscal stimulus, creating new employment opportunities and laying the foundations for economic growth whilst committing to essential investment in our infrastructure.

As the OECD advise continued support at the global level and the Bank of England embark on new forward guidance, the FPP have also indicated that we should be giving discretionary support to the Jersey economy.

Budget 2014 allocates significant capital investment in 2014 totalling over £90m including:

- over £15m in education including significant investment in new primary school accommodation;
- £15m in health including upgrading main theatres;
- £25m in our transport and wider infrastructure from roads to sewage treatment; and
- over £20m in social housing.

In addition the capital programme in 2014 will be managed to try and deliver these projects in a manner which meets the FPP's 3Ts – timely, temporary and targeted. These projects are essential investment in their own right that will bring with them their own economic benefits but will be managed in such a way to maximise the support for the economy and help maintain and create employment opportunities at a time when they are most needed. Current survey evidence suggests the construction businesses in the Island have significant spare capacity – in June 2013 nearly 50% of construction businesses indicated that they were operating below capacity. In addition, a net balance of -18% of construction firms stated that there were likely to reduce employment in coming months.

At a time when unemployment remains at high levels, it is vital that the public sector does what it can to support the economy, particularly when private sector activity may take time to recover. Budget 2014 goes further than providing stimulus in the short-term and continues to provide support for the key policy areas of Back to Work and the Economic Growth and Diversification Strategy. Back to Work will help to minimise the costs to both the individual and society of the current levels of unemployment and ensure we do everything we can to get those out of work, particularly the young back into employment as quickly as possible.

We must build for the future and lay the foundations for economic growth now which will benefit us in the future. Budget 2014 cements the support for the Economic Growth and Diversification Strategy in all the 4 key areas including the new £5m Innovation Fund, supporting the continued growth and diversification of the financial services sector and a new enterprise strategy that will deliver new high value and high growth business and raise the productivity of the whole economy.

The Minister for Social Security has already published a report in August on the new Long Term Care scheme that will help Islanders pay for care, either in their own home or in a care home. If the States agree, the new long-term care scheme will start in July 2014, offering greater protection for hard working Jersey families. However, although the benefits from the scheme would be available from next year, contributions to the scheme would not begin until 2015 at 0.5% of taxable income, rising to 1% in 2016. To prevent money being taken out of the economy while it is still under pressure, the Treasury has worked with Social Security to make it possible to reallocate existing Social Security budgets to avoid the need to introduce a 1% contribution in 2014. This will prevent a further squeeze on Islanders' disposable incomes and at a time when we are supporting the economy through fiscal stimulus.

Budget 2014 goes further though and gives something back to hardworking Islanders who have had to carry on through difficult economic times as we have faced the fallout from the global financial crisis. Our strategic approach to fiscal policy in response to both the move to 0/10 and the need to repair revenues after the global financial crisis has been consistent in focusing on raising revenue through indirect taxation, recognising the risks that other forms of taxation pose to the economy. Having taken these difficult decisions in the past and keeping our finances on a strong and sustainable footing we can afford to give something back. Budget 2014 sets out to do this in a manner consistent with previous fiscal strategies, by cutting the marginal rate of income tax from 27% to 26%.

The reduction in the marginal rate will reduce the tax liability of approximately 84% of the Islands income tax paying population – around 40,000 households. It will put nearly £8m back into Islanders pockets in 2015 after they have experienced a continued squeeze on their incomes in recent years. It will complement the significant capital programme next year and beyond in creating fiscal stimulus that supports employment and growth next year. We can all take reassurance from the Bank of England statements on forward guidance, but Islanders can also take additional confidence from the fact that given our strong financial position we can go further and actually reduce the tax burden for the vast majority of tax payers at a time when we will also be undertaking significant capital investment in the local economy.

Overall Budget 2014 balances the needs for short-term fiscal support to boost employment with the need to underpin economic growth and job creation policies in the medium term. It provides the fiscal stability and certainty that will help growth flourish and at the same time commits to the essential investment the Island needs in areas such as health, social housing and liquid waste. Supporting the economy and investing to improve our competitiveness now will mean we are in the strongest position possible as the global economy continues to improve.

# PART F – MAJOR CAPITAL SCHEMES FUNDING OPTIONS

# 11. Funding Options for the Three Major Schemes

## 11.1. Introduction

Jersey faces some significant capital investment requirements in the key services areas of health, housing and transport and technical services. Much of Jersey's future capital requirements can be met in the traditional way from current year revenues or from other sources such as capital receipts. However, the following three major schemes demand a re-think of the States' approach to funding major Island infrastructure that has both a long life and long term benefits to the Island.

1. The development of a hospital services and facilities ("the Hospital Project").

2. The need for more and better housing stock ("The Housing Project").

3. The need for an efficient and appropriate Liquid Waste infrastructure for the Island ("the Liquid Waste Project").

This section of the Report summarises the service needs identified by Departments, the likely capital requirements for each project and the potential funding options for consideration and decision.

In brief the funding options that have been explored are:-

1. Borrowing from the external sources ("capital markets").

2. Internal borrowing through investment and subsequent repayment of the States' own resources, for example through an infrastructure investment from the Currency Fund.

3. The use of States existing resources, in particular the proposed limited use of investment returns from the Strategic Reserve Fund.

First of all a reprise of the need for service improvement in these areas. The States has already received very detailed proposals in the Housing Business Case (R015/2013) and the Housing White Paper (P.33/2013) together with the proposition "Health and Social Services: a new way forward" (P.82/2012). The need for the service improvement in these areas has been thoroughly debated by the States but relevant extracts are used in this Report for ease of reference.

The Liquid Waste Project is smaller than those proposed for Health and Housing. Whilst it is a substantial and important project, providing a service critical to our daily lives, it is part of TTS's ordinary business. Even so, the TTS Minister has plans to bring forward a Liquid Waste Strategy for full consideration by States Members and to provide full briefings and tours of the existing plant and equipment to help Members in their deliberations.

# 12. The need for improvement and replacement of Hospital, Housing and Liquid Waste Facilities

## 12.1. Hospital Project – The Current Position

### Health and Social Services – A New Way Forward

The Health and Social Services Report and Proposition P.82/2012, approved by the States Assembly on the 23rd October 2012, sets out the vision of an integrated care model and a programme of change that will meet the challenges facing the Island's future Health and Social Services.

Central to the development of this vision is the need to have an acute general hospital which is fit for purpose, capable of sustaining the acute care provision requirements for the population and complements the integrated care strategy being developed for Jersey.

Consultation showed that Islanders want Health and Social Services that are:

**'Safe'** – while many health interventions involve inherent levels of risk, that patients and service users should not be exposed to an undue level of risk.

**'Sustainable'** – that services should be organised in a way that is not vulnerable to change in the short term.

**'Affordable'** – that the model of services represents value for money relative to other potential models.

P.82/2012 makes clear that new hospital capacity will be required within 10 years. In fact, bed space is already too constrained and winter pressures could lead to the cancellation of appointments as early as 2014. The Council of Ministers is of the opinion that, given the long lead in time needed to develop new and replacement facilities, construction work should begin without delay in the best interests of protecting the health and safety of Islanders.

The States of Jersey appointed WS Atkins to review the condition and development potential of the existing General Hospital. Their report confirmed the following:

- The total floor area of the combined hospital buildings (circa 38,500m²) is about 60% of that needed for a full new hospital to modern standards (63,600m²).
- A condition assessment carried out in 2008 assessed the majority of the building as being in category C or D – i.e. needing significant investment or replacement.
- Poor configuration and/ or condition meant that some of the existing buildings have limited potential for clinical use or development in a future hospital.
- The layout of the hospital means that there is little opportunity to intensify uses on the current plot and any development would need to be phased.

WS Atkins concluded that a complete redesign and increase in the size of the existing Hospital is required, not only to meet the future acute clinical needs of the growing population of Jersey, but also to address the increase in space standards required to meet current best clinical, spatial and operational practices.

WS Atkins reviewed hospital activity, service development plans and proposals for delivering more health services in the community to establish the scale of future hospital capacity required.

Assuming 2011 Census projections and that proposals within P.82/2012 are successfully implemented, new hospital capacity of circa 300 beds will be required.

Pressures on bed numbers will grow before new hospital capacity is available such that by 2017 up to 50 additional beds will be required to avoid permanent bed crisis.

WS Atkins undertook a Pre-Feasibility Spatial Assessment for the hospital development. Jersey Property Holdings were commissioned to undertake a spatial assessment for new Hospital capacity to inform P.82/2012

- The Planning and Environment Geographical Information System was employed for the subsequent site search.

- A cross-Departmental Officer group reviewed 24 potentially suitable sites and identified a long-list of 11 sites for review by WS Atkins International – a respected hospital master-planning consultant.

- All sites of sufficient footprint (18,000m²) within or adjacent to the Built Up Area were reviewed against set criteria including green and brownfield sites.

- Potential sites suggested by the Minister for Planning and Environment were also reviewed.

- Potential sites were drawn up and evaluated by WS Atkins using cost, benefit and risk criteria. WS Atkins recommend a short-list of 3 sites.

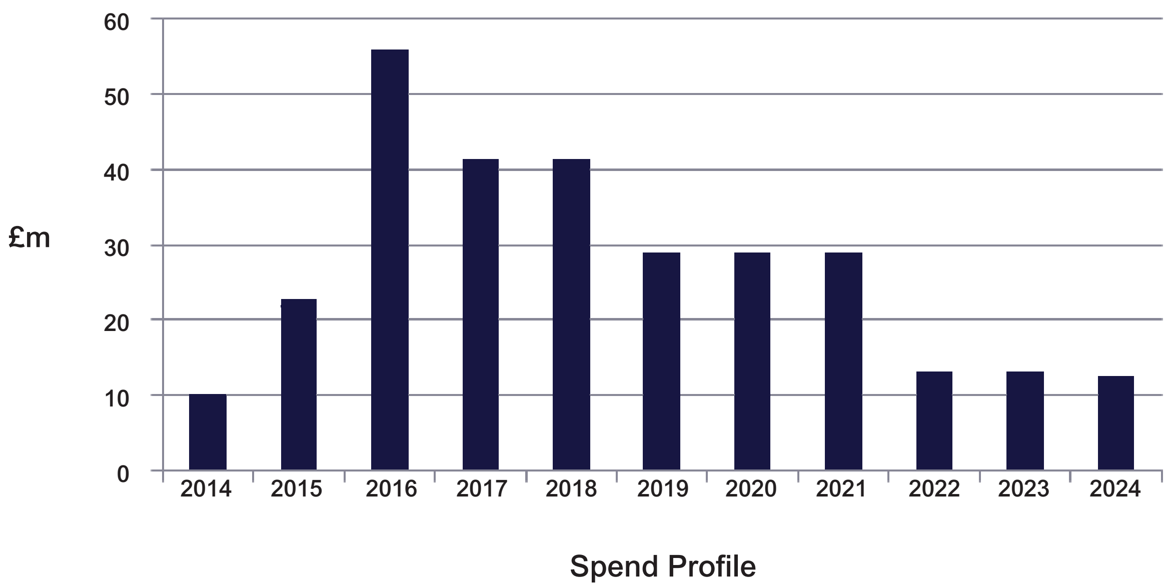
A range of site options were considered and shortlisted to three that have been assessed in more detail. This report does not seek decisions about the final outcome of the process that will determine which of the sites is eventually chosen as the best option nor about the detail of the design and configuration of the buildings.

## 12.2. Hospital Project Funding Requirements

The same issues and principles need to be addressed when considering funding options, regardless of the final decision on the site and design. This paper is about funding mechanisms. For the purposes of this paper one of the options has been used as the basis for assessing the most appropriate and affordable funding option. This option is summarised in Appendix A at the end of this section. In brief, the costed option is to refurbish and undertake some new building works on the existing site and in addition to develop a substantial new building for the treatment of patients with long term conditions at Overdale. Facilities such as the diabetic clinic, renal dialysis, the pain clinic and day surgery could be included at Overdale in a two site solution that has the potential to maximise the investment made in the existing hospital and provide a long term solution to meet the current and future pressures.

The hospital project is forecast to spend over 10 years from 2014 to 2024. The chart below shows the estimated cost of the hospital project and the estimated spend profile.

FIGURE 22 – ESTIMATED HOSPITAL CAPITAL REQUIREMENTS




| | Dec 2014 | Dec 2015 | Dec 2016 | Dec 2017 | Dec 2018 | Dec 2019 | Dec 2020 | Dec 2021 | Dec 2022 | Dec 2023 | Dec 2024 | Total |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| £'m | 10.2 | 22.7 | 55.9 | 41.4 | 41.3 | 28.9 | 28.9 | 28.9 | 13.1 | 13.1 | 12.6 | 297.0 |

## 12.3. Housing Project – The current position

There is a requirement to upgrade the social housing stock on the Island to 'Decent Homes Standard' as well as to increase the availability of social housing.

States approval was granted on 16th May 2013 (P.33/2013: The Reform of Social Housing) to enable the Housing Department to become incorporated into a new, not for profit, wholly States owned Housing Company. This will provide the new housing company with powers to borrow in its own right so as to facilitate investment, improved control and management of housing stock.

A key objective for these improvement works is to ensure that the housing stock meets the Decent Homes Standard within ten years.

The structure of the new Housing Association is to be a company limited by guarantee, whose sole guarantor member is the States of Jersey.

Being a company limited by guarantee, the States membership of it is not transferable. The Minister for Treasury and Resources will exercise the powers of the States in their capacity as sole guarantor member and must act in the interest of the States.

Fundamental to the States approving the establishment of the new Housing Company was the production of a Full Business Case. This is set out in R.15/2013 and was presented to the States on 4th March 2013. This makes clear the need for borrowing.

A critical element of the proposed change is that social housing rents are returned to near market fair rents levels.

On 17th July 2013, the States approved the Draft Social Housing (Transfer) (Jersey) Law 201_ (P.63/2013). This is the Law that provides for the States to transfer agreed assets, rights and liabilities to the new company limited by guarantee.

## 12.4. Housing Project Funding Requirements

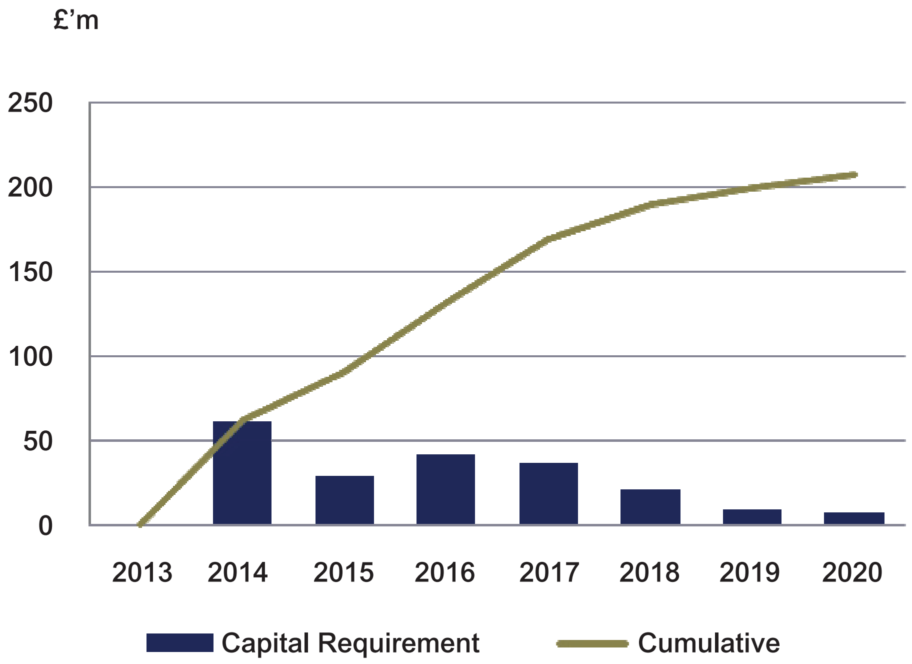
The financial model presented to the States of Jersey as part of the Report and Proposition R15/2013 and P.33/2013 has been used as the basis for estimating the future capital funding needs of the new housing company. The Housing financial model necessarily covered all aspects of service delivery including capital investment, inflation and debt charges. Figure 23 shows the estimated spend profile.

The housing financial model was developed on the basis that the new Company would borrow to meet its spending needs and repay the debt using the rental income associated with the new or refurbished properties.

It is assumed in this report that the interest charge on borrowing for housing purposes should be similar to best current estimates of the coupon rate on a 30 year bond issue. Therefore the interest charge in this report has been estimated at 4.3% (the assumption in the Report and Proposition R.15/2013 and P.33/2013 was a more prudent 5%). This means that if there were any fluctuation in interest rates that Housing have an element of contingency within their financial model. It is assumed that spending on the Housing Project commences in 2013.

A schedule of the housing schemes that could be carried out with this funding is set out in Appendix B at the end of this secton.

FIGURE 23 – ESTIMATED HOUSING TRANSFORMATION CAPITAL REQUIREMENTS



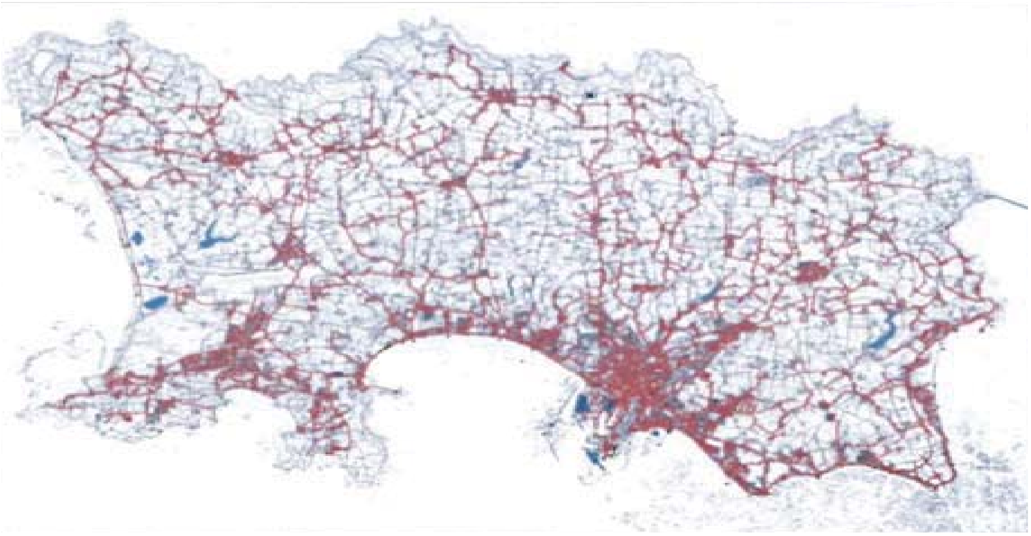

| £'m | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | Total |
|---|---|---|---|---|---|---|---|---|---|
| Housing Transformation | 0.3 | 61.7 | 28.8 | 41.5 | 36.7 | 20.8 | 9.7 | 7.7 | 207.2 |

The housing project funding also provides for the repayment to the States of Jersey of £40 million of funding provided to Housing in advance of incorporation so as to facilitate the building of additional homes at a time of economic downturn. This advance funding was provided in the short term, from the Consolidated Fund and will be repaid into the Consolidated Fund and then applied to finance the States' main capital programme as approved in the Medium Term Financial Plan 2013 to 2015.

## 12.5. Liquid Waste Project – The current position

This investment relates to the Replacement Sewage Treatment Works ('STW') at Bellozane. The safe disposal of Jersey's waste water is vital to keeping the Island safe to live in and its surrounding waters cherished for all aquaculture. This is very much an unseen essential service, a service that may be taken for granted but is critical to public health and safety.

FIGURE 24 – A MAP OF THE ISLANDS SEWERAGE NETWORK



The Transport and Technical Services Department ('TTS') has provided details of the anticipated plan for completion of the works, which is outlined below.

- Q2 2013: Feasibility study completed
- Q4 2013: Tender design complete
- Q3 2014: Planning and Environmental approvals
- Q4 2014: Tender and appoint contractor
- Q4 2014: Demolition and clearance of existing services
- Q2 2015: Clinical Waste Incinerator (CWI) facility relocated
- 2015–2016 : Construction of replacement STW

There is an enormous network of drains (570 kilometres of pipelines) to take the waste water from homes and businesses, a 25,000m³ Cavern storage tank to help cope with storm waters, 116 pumping stations to pump the waste water uphill, an automated monitoring alarm system enabling a quick reaction to problems when they arise, a sewage treatment works and associated plant to separate and treat the liquids and solids and then the drains to send the purified water out to sea.

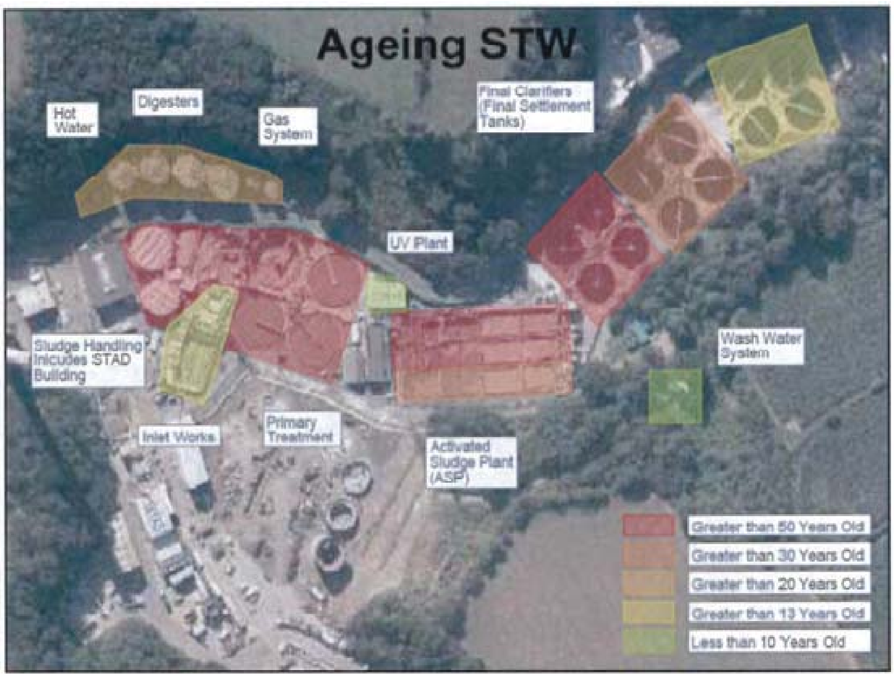
- Much of the existing network, particularly in St Helier, was built in Victorian times. There is a need for a long-term programme of repair and replacement.
- The network struggles to cope in times of heavy or accumulated rainfall. High rainfall occurs for about a third of the year.

- An inflow and infiltration reduction programme is needed to minimise the amount of water entering the sewage network and thereby reduce costly treatment.
- Whilst flow reduction improves the sewage capacity, it does not affect the *treatment* capacity requirements which are driven by the number of people using the service.
- The cavern fulfils an essential storage role and is in use on average 53 times a year and helps prevent a repeat of the flooding that plagued householders in previous years.
- More storage capacity is needed and this is proposed for the west of the Island. This will reduce the number of spills of diluted waste water from the network.
- The priority is to bring the current network up to the required standard and maintain it in a sustainable manner at this level before expanding the network by adding more properties in areas where it is economically viable.

There are three main drivers for change. These are:

- Legal – The current Sewage Treatment Works is breaching consent conditions.
- Operational –the infrastructure is failing leading to high maintenance costs.
- Environmental – Water Framework Directive.

FIGURE 25 – THE AGEING SEWAGE TREATMENT WORKS AT BELLOZANNE



The Bellozanne Sewage Treatment Works is ageing. Almost 50% of the plant is more than 50 years old. High levels of maintenance are required and replacement will provide better value for money over the medium to long term. Current problems include:

- an outdated design;
- difficulty in taking one secondary treatment lane out of service for maintenance without affecting the current overall plant performance;
- poor performance of the high rate aeration system;
- unreliable performance of the secondary treatment process that causes periods of high DO and over aeration;
- poor distribution between final settlement tanks; and,
- limited opportunities for partial upgrades that will meet current and future needs.

FIGURE 26 – THE DECAYING INFRASTRUCTURE FROM THE 1950'S

The Transport and Technical Services Department ('TTS') has provided details of the anticipated plan for completion of the works, which is outlined below.

- Q2 2013: Feasibility study completed.
- Q4 2013: Tender design complete.

- Q3 2014: Planning and Environmental approvals.
- Q4 2014: Tender and appoint contractor.
- Q4 2014: Demolition and clearance of existing services.
- Q2 2015: Clinical Waste Incinerator (CWI) facility relocated.
- 2015-2016 : Construction of replacement STW.

## 12.6. Liquid Waste Funding Requirements

The Liquid Waste Project draft feasibility study prepared by TTS, estimates the capital costs of the Sewage Treatment Works (STW) Project to be £75m. An analysis of the estimated costs is set out below together with and the estimated profile of spend.

FIGURE 27 – ESTIMATED LIQUID WASTE CAPITAL REQUIREMENTS

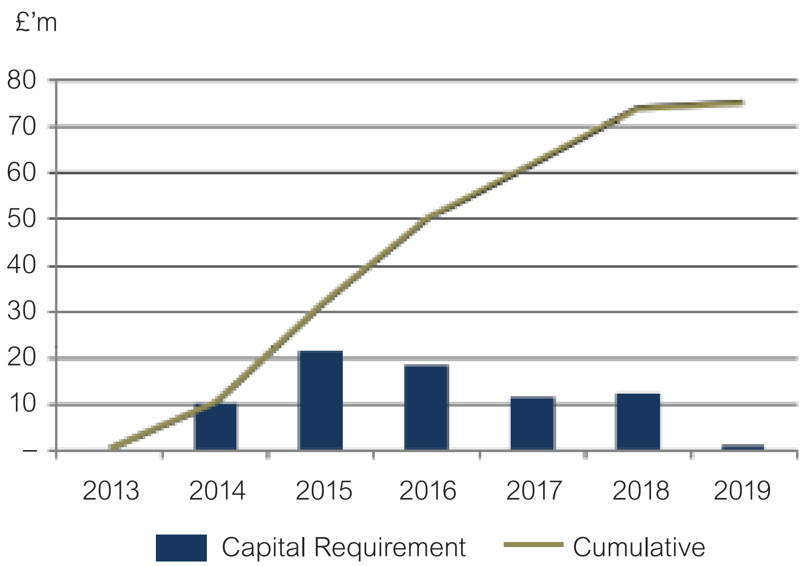



FIGURE 28 – ESTIMATED LIQUID WASTE CAPITAL REQUIREMENTS

| £'m | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | Total |
|---|---|---|---|---|---|---|---|---|
| Liquid Waste | 0.5 | 10.1 | 21.2 | 18.5 | 11.4 | 12.2 | 1.1 | 75.0 |

The technical solutions to solving the challenges of sewage treatment will be fully evaluated and subject to separate detailed reports. The effective operation of the sewage treatment works is a priority for TTS, hence considerable investigative and technical appraisal has been undertaken in the ordinary course of the work of the department. Appendix C at the end of this section provides some further background information on the project in addition TTS extends open invitations to visitors who would like to see the treatment works in operation in order to gain a better understanding of the operational issues at first hand.

This report now focuses on the funding options that are available to meet the costs of investment in the Island's hospital, housing and liquid waste infrastructure.

## 12.7. Funding options for the three major capital schemes

### The Funding Options Available

The previous section of this report has set out in summary the spending needs of the three major capital schemes.

This section of report sets out the funding options available to the States being:

1. borrowing from external sources ("capital markets");

2. internal borrowing through investment of States' own resources for example through an infrastructure investment from the Currency Fund; and

3. the use of States' existing resources.

The Report now deals with each of these funding options in turn.

### Borrowing from External Sources: A Brief Overview of the History of Borrowing by The States of Jersey

The States of Jersey has made limited, judicious use of borrowing in the past for the purposes of meeting the cost of major investments in infrastructure that has a long term benefit for the Island. Relevant examples of previous borrowing by the States are set out below.

#### The Telephone Loans 1970/90 (Jersey) Law 1956

These loans were issued to meet the cost of constructing a new telephone exchange to serve the Central and Millbrook areas and part of the Five Oaks area.

#### Housing Loans (Jersey) Law 1964

The housing loans were issued "to raise under the guarantee of the General Revenue of the States, loans of a total amount of £2,000,000 for housing purposes. The said loans shall be issued at such times, and in such amounts and subject to such conditions as the Finance Committee may direct, in the form of stock registered in the books of the Treasury of the States, or of bonds payable to bearer, and shall bear interest at such rate as the Finance Committee may determine in relation to the Loan to be issued."

### Sewerage Loans 1975/90 (Jersey) Law 1953

These loans were “to meet the cost of construction of public sewers and sewerage disposal works, of acquisition of land or interest in land for the purposes of the disposal of sewerage and generally providing for the sewerage of the Island.”

### House Construction Loans 1975/95 (Jersey) Law 1960

These loans were issued for housing purposes.

The method used by the States in the past, the issuance of public bonds, to fund Island infrastructure is still a valid option today. However, a range of options have been considered and evaluated and the next section of this Report describes some of the work that has been done.

# 13. Funding Markets Overview

## Summary of the Funding Markets

There are a number of external funding options and markets potentially available to the States of Jersey. These are as follows:

- Rated public bond
- Unrated public bond
- Public retail bond
- Private placement bond
- Project finance
- Bank finance.

The table on the following page summarises the key features of the various external funding options available to the States of Jersey from public bond through to bank debt. The Table shows each of the funding options and characteristics of each. The pros and cons are then summarised. Treasury has considered factors such as: Is the funding denominated in sterling, or will there be currency exchange rate risk? Does the market have sufficient capacity to meet Jersey's needs? Is the term long enough for Jersey's purposes and so on.

Expert advice on external funding options has been taken from Ernst & Young's capital markets team and in the paragraphs that follow there is further detail on each option. Please go straight to the section headed "Summary of the Suitability of Funding Markets" on page 104 if you do not wish to review all of this detail.

## FIGURE 29 – SUMMARY OF EXTERNAL FUNDING OPTIONS

| | Public Bond (rated) | Public Bond (unrated) | Retail Bond (listed) | US Private Placement | Project Finance | Bank Debt |
|---|---|---|---|---|---|---|
| **Currency** | GBP, EUR, USD | GBP, EUR, USD | GBP, EUR, USD | USD, GBP | GBP, EUR, USD | GBP, EUR, USD |
| **Liquidity capacity** | £200m+ (could go lower with an illiquidity premium) | £200m+ (could go lower with an illiquidity premium) | < £100m | £25-500m | £50m+ | £20m+ |
| **Maturity** | 5-50 years | 5-50 years | 3-10 years | 3-30 years | 5-25 years | 1-7 years |
| **Financial covenants** | Typically none | May be required | None | Typically bank style covenants | Required, typically cashflow driven | Yes |
| **Credit ratings** | Minimum one required | N/A | Typically required | Private ratings may be required | Not required | Not required |
| **Inflation-linked** | Direct is an option | Direct is an option | Direct is an option | Direct is an option | Via swaps | Via swaps |
| **Investor relationships** | No | No | No | Yes | Yes | Yes |
| **Pros** | • Deep and liquid market<br>• No financial covenants<br>• Historically attractive fixed coupon cost<br>• Long tenors available<br>• Benchmark issue lays ground for future issues | • Reasonably deep market<br>• No financial covenants<br>• Reasonably attractive fixed coupon cost | • Access to alternative investor base<br>• No financial covenants | • No public credit rating required<br>• Historically attractive fixed coupon cost<br>• Flexible maturities available | • Non-recourse bank debt<br>• Suitable for investment capex where there is a construction period<br>• Flexibility in drawdown and repayment profiles | • Simple to arrange<br>• Flexibility in drawdown and repayment profiles |
| **Cons** | • Public credit rating and ongoing disclosure requirements<br>• Minimum deal size of £200m<br>• Early redemption costs | • Price premium compared to rated public bonds<br>• Minimum deal size of £200m<br>• Early redemption costs | • Bespoke disclosure and documentation requirements<br>• Less capacity than public market | • Financial covenants required<br>• Early redemption costs<br>• Typically more costly than public markets<br>• Long dated swaps would be required | • Security required<br>• Can be complex in structuring<br>• Lengthy arrangement process | • Shorter tenors than other markets<br>• Refinancing risk |
| **Pricing** | 10yr: Gilts + c. 65bps<br>30yr: Gilts + c. 80bps | 10yr: Gilts + c.90 bps<br>30yr: Gilts + c.105 bps | 10yr: c. 4.5%<br>30yr not likely available | 10yr: Gilts + c.115 bps<br>30yr :Gilts + c. 130 bps | 25yr: LIBOR + c.275 bps | 10yr not likely available |

# Public Bond Markets

A decision for the States to take external borrowing would mark a significant departure from previous practise unless certain conditions are satisfied. First the States does not borrow to meet current year expenditure. The three major projects are all investments that will serve Islanders for at least two generations. Secondly the States must be able to maintain its strong and stable balance sheet and repay the debt, both principal and interest. If the borrowing is taken for housing purposes then this can be achieved with rental income used to repay the debt. Financial assets (cash) on the Balance Sheet is replaced by physical assets (housing) in a company wholly owned by the States.

The next part of the Report provides detailed information on funding markets – some readers may prefer to move straight to section 3.2 which deals with their suitability for Jersey.

## Market backdrop

Public bonds are priced with reference to benchmark 'risk free' rates (for example UK Gilts in the Sterling market and German Bunds in the European markets). As highlighted in the graph below, benchmark rates are currently near historic lows which has led to opportunities for issuers to raise long term fixed rate debt at record low coupons (interest rates).

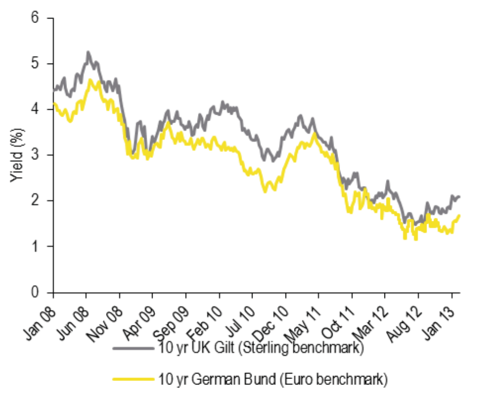
The market for bonds will be dependent on a clear communication of the credit proposition by the States, a well structured marketing process and an appropriately priced and sized offering.

Despite the economic downturn, the public bond market continues to show interest in lending to organisations like the States of Jersey with a strong credit history. This is evidenced by the number of successful issuances over the last year.

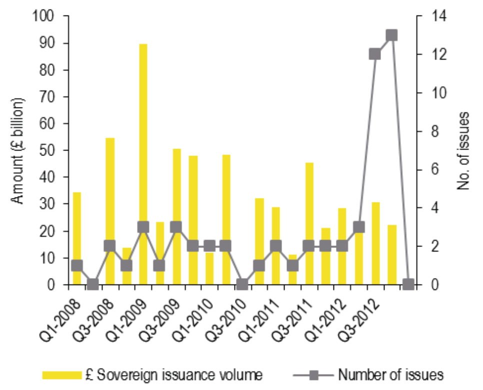
The public bond market offers the opportunity to raise significant sums with a "bullet" payment to repay the principle at the end of the period.

The chart below shows that the Sterling public bond market has continued to offer an available source of finance for sovereign countries. 2012 has seen a sharp increase in the number of deals of a size comparable with the possible funding requirement for the States of Jersey.

### FIGURE 30 – GOVERNMENT BENCHMARK BOND YIELDS




### FIGURE 31 – SOVEREIGN ISSUANCE IN THE £ BOND MARKET




## Sterling bond market

The Sterling bond market offers a route for the States of Jersey to raise long term debt finance.

The Sterling market offers adequate depth to provide a first time issuer like Jersey with a level of financing that would meet our requirements. It is market standard that an issuance is a minimum of c.£200m to create adequate liquidity in the security.

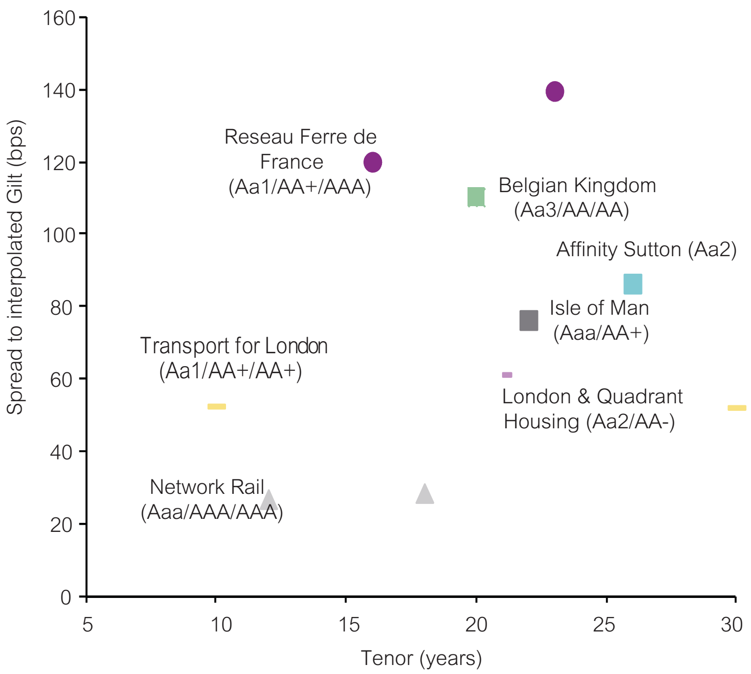
The pricing of recently issued bonds that those issuers with a close link to the UK Government (e.g Network Rail, Isle of Man) achieve the lowest cost of funds, followed by Government related entities (e.g. Housing Associations). Pricing varies from a spread of c.55 – 77 bps for a 10 year bond increasing to potentially over 150bps for a 25 year AA-rated bond due to the credit quality of the borrower. ( A “spread” just means the amount of interest paid above a benchmark rate, typically base rate. “Pricing” simply means the interest rate that is paid). It must be noted that pricing (the interest rate paid) varies over time due to movements in the underlying benchmark (typically base rate) and spreads (the premium paid above base rate – the worse the credit rating of the borrower, the higher the premium paid because of the risk of default).

Of the comparables identified below the States of Jersey is most closely comparable to Transport for London due to both these entities being domestic issuers and having a link to the UK Government. These historical deals are shown for reference purposes only. They give a helpful indication of the extent to which interest rates vary with the period over which the funds are borrowed. This loan period is referred to as the "tenor".

## FIGURE 32 – PRIMARY STERLING MARKET HIGH INVESTMENT GRADE ISSUANCE

| Date | Issuer | Rating (M, S&P, F) | Amount (£m) | Tenor (years) | Coupon | Spread (G+bps) | Mandated Lead Arranger |
|---|---|---|---|---|---|---|---|
| Jan -13 | Network Rail | Aaa, AAA, AAA | 750 | 4 | 1.000% | 28 | Deutsche Bank, HSBC, RBS |
| No v-12 | Nestle | Aa2, AA, AA+ | 400 | 10 | 2.250% | 65 | Barclays, Goldman Sachs, HSBC, RBS |
| No v-12 | Transport for London | Aa1 AA+, AA+ | 300 | 5 | 1.250% | 55 | Barclays, HSBC, Morgan Stanley |
| Oct-12 | Deutsche Bahn | Aa1, AA, AA | 300 | 5 | 1.375% | 41 | Barclays, Credit Suisse, Mitsubishi |
| Oct-12 | University of Cambridge | Aaa NR, NR | 350 | 40 | 4.750% | 65 | HSBC, RBS, Morgan Stanley |
| Aug -12 | Transport for London | Aa1 AA+, AA+ | 500 | 10 | 2.250% | 77 | Deutsche Bank, Goldman Sachs, HSBC |
| Aug -12 | Libra Treasury | Aa3, NR, NR | 250 | 26 | 5.125% | 169 | Barclays, Lloyds |
| Jul-12 | Transport for London | Aa1, AA+, AA+ | 500 | 30 | 3.875% | 65 | Deutsche Bank, Goldman Sachs, HSBC |

## FIGURE 33 – SECONDARY STERLING MARKET COMPARABLES



## Euro bond market

The Euro bond market is open and active and can offer lower coupons than the Sterling bond market for certain issuers. This is due to the benchmark rate (i.e. Bund rate) currently being lower than the benchmark rate (i.e. Gilt rate) in the Sterling bond market. However, tenors achievable are typically shorter than the Sterling bond market with issuance over 10 years being rare.

As with the Sterling market, domestic issuances from European entities achieve the best pricing. Therefore, the States of Jersey may have to offer Euro bond investors a small premium compared to a European based issuer.

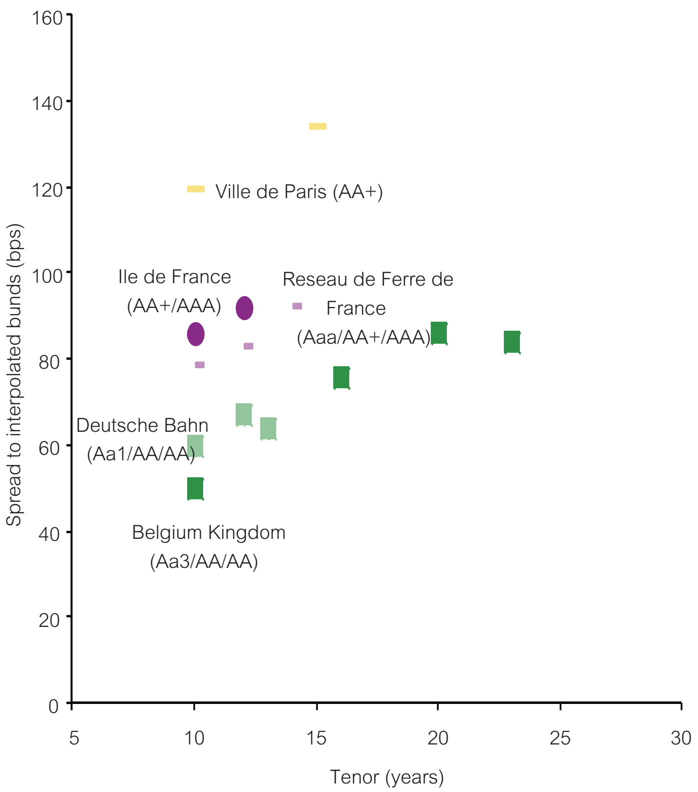
The Euro bond market's suitability for the States of Jersey is limited as the States of Jersey has very little revenue that is denominated in Euros (i.e. only a few million pounds per year income for the airport). This means that although it might have a lower coupon, there is significant currency risk on the repayment of principal.

This risk could theoretically be hedged, but the cross-currency swap will add to the risk and cost of the bond issue.

### FIGURE 34 – PRIMARY EURO MARKET STATE-LINKED ISSUANCE

| Date | Issuer | Rating (M, S&P, F) | Amount ( m) | Tenor (years) | Coupon | Spread (B+bps) | Mandated Lead Arranger |
|---|---|---|---|---|---|---|---|
| Jan-13 | Sweden | Aaa, AAA, AAA | 4,000 | 5 | 0.880% | 23 | Danske, Goldman Sachs, JP Morgan, RBS |
| Jan-13 | Kingdom of Belgium | Aa3, AA, AA | 4,000 | 10 | 2,250% | 62 | Barclays |
| Oct-12 | State of Nordrhein-Westfalen | Aa1, AA-, NR | 300 | 10.5 | 2.000% | 50 | Barclays, Landesbank Baden-Württemberg, Commerzbank |
| Sep-12 | Stockholm | Aaa, AA+, NR | 500 | 10 | 2.125% | 62 | - |
| Sep-12 | State of Nordrhein-Westfalen | Aa1, AA-, NR | 750 | 10 | 1.875% | 46 | DZB Bank, HSBC, Natixis Unicredit |
| Aug-12 | State of Berlin | Aa1, NR, AAA | 250 | 8 | 1.500% | 49 | Landesbank Baden-Württemberg, Unicredit, WGZ Bank |
| Aug-12 | State of Brandenburg | Aa1, NR, NR | 150 | 8 | 1.500% | 53 | WGZ Bank |

FIGURE 35 – SECONDARY EURO MARKET COMPARABLES




## Considerations as to the Size of The Bond Issuance

Typical investors are large sophisticated institutions. The liquidity of a transaction is of critical importance to investors and a minimum size of £200m–£250m is typical because of concerns over liquidity, index eligibility and the size of the ultimate holding.

FIGURE 36 – CONSIDERATIONS AS TO THE SIZE OF BOND ISSUANCE

| Issue Size | £125m and less | £175m | £200m | £250m |
|---|---|---|---|---|
| Comment | Some investors may not participate given sub £200m ('benchmark') size and others are likely to demand an illiquidity premium | Preferable to a £150m issue, however, similar concerns over liquidity apply | Most sterling investors would view a transaction of this size to be of interest, but remains ineligible for the iBoxx index | Optimal size, which is eligible for all indices and will be viewed as relatively liquid |
| Pricing impact | + c.15-25bps | + c.5-10bps | + c.0-5bps | None |

FIGURE 37 – BOND INDEXES – FOR TRADING PURPOSES

| Index provider | Relevance | Threshold |
|---|---|---|
| markit | High | £250m |
| Bank of America Merrill Lynch | High | £100m |
| BARCLAYS CAPITAL | Low | £200m |

Bonds on the public market can be openly traded after issuance and holders of the securities can change many times. Investors will therefore ask for liquidity and would want bonds to be included in one or more indices. Bonds that are liquid and regularly traded are sought after and tend to attract tighter pricing (that is, lower interest rates). This is because it makes it is easier for holders to sell these instruments in the secondary market.

The inclusion of the bond on one or more indices will mean that the price movement of the bond, once issued, will be open and transparent.

The indices comprise a vast universe of bonds that contribute to their price. For example, the Markit iBoxx Sterling Benchmark Index had more than 1,000 constituents totalling £1.5tn (at the end of 2011). Therefore an issuance by the States of Jersey would not move the index, the bonds would be more easily tradeable and therefore more liquid and attractive to investors.

### Rating considerations

In order to issue in the public bond markets it is standard market practice that an issuer will obtain at least one public rating from either Moody's, S&P or Fitch. It is more common that an issuer will have two ratings. Public credit ratings provide investors with a level of transparency and assurance to allow them to fully understand the credit profile of the bonds being offered. Unrated issues tend to be reserved for well known large entities with a well understood credit profile. Unrated issuance from Government related entities is extremely rare. Further information on credit ratings and the process of getting and managing a credit rating is set out in Appendix D at the end of this section.

## Public Bond Markets Considerations

**Retail bonds offer an alternative source of funding**

Whilst public bonds are traditionally bought by institutional investors, an alternative option is to target retail investors (private savers). Listed retail bonds are sold through a network of brokers and are tradeable on the London Stock Exchange Order Books for Retail Bonds ('ORB') platform. Since the ORB platform was launched in 2010, it has raised £2.8bn for a number of corporates.

The retail bond market allows issuers to offer their stakeholders (customers, employees, residents) the opportunity to be part of their development through investment in the issuer, whilst in many cases providing savers with an attractive yield on their investment when compared to traditional savings products.

In 2011 the Belgian government launched a €200m bond issue targeted at retail investors, this was increased due to strong demand and closed at €5.7bn. Investors were offered a 4% coupon for the 5-year deal.

A retail bond could potentially provide an opportunity to attract local Jersey non-institutional investors. However, as seen in the table below, the Sterling retail bond market cannot provide either the tenor or the quantum required by the States of Jersey to meet its funding requirements. It would also be likely to price significantly higher than an institutional bond of equivalent tenor and size and therefore would be a more expensive route than borrowing from institutions.

FIGURE 38 – NEW ISSUES ON THE ORB LISTED BOND MARKET

| Date | Issuer | Amount (£m) | Tenor (years) | Coupon |
|---|---|---|---|---|
| Feb-13 | En Quest | 145 | 10 | 5.500% |
| Dec-12 | Alpha Plus | 48.5 | 7 | 5.750% |
| Dec-12 | UNITE Group | 90 | 8 | 6.125% |
| Dec-12 | Tullet Prebon | 80 | 7 | 5.250% |
| Oct-12 | London Stock Exchange | 300 | 9 | 4.750% |
| Oct-12 | St. Modwen Properties | 80 | 7 | 6.250% |
| Oct-12 | Workspace | 58 | 7 | 6.000% |
| Sep -12 | Intermediate Capital Group | 80 | 8 | 6.250% |
| Sep -12 | CLS Holdings | 65 | 7 | 5.500% |
| Jul-12 | ICAP | 125 | 6 | 5.500% |
| Jul-12 | Primary Health Properties | 75 | 7 | 5.375% |
| Jul-12 | Severn Trent | 75 | 10 | RPI lin ked |
| May-12 | Tesco Personal Finance | 200 | 8 | 5.000% |
| May-12 | HSBC | 196 | 3 | 2.875% |

## Private Placement Bond Market

The Private Placement bond market has seen volumes surge and pricing fall.

The Private Placement market has been robust, has remained open and shown continuing investor appetite throughout the period since 2008 despite wider market volatility. This is demonstrated by the issuance volumes in the chart below, with the two most active months of the last three years occurring in 2012.

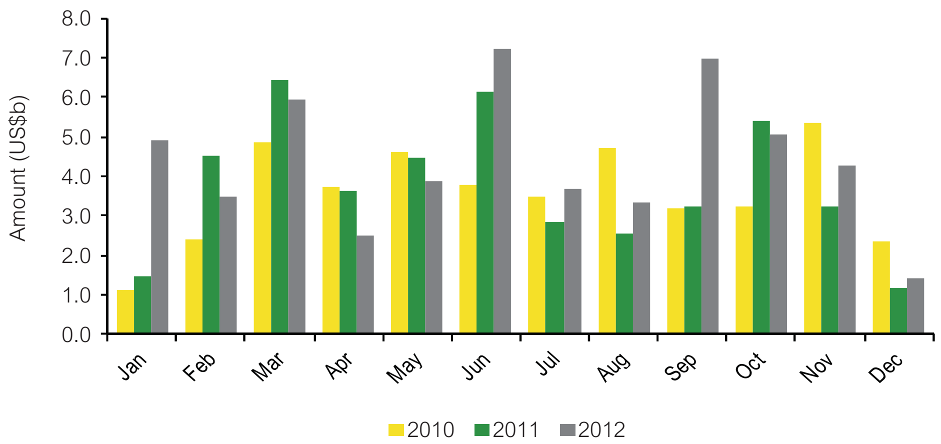
A Private Placement bond is typically sold directly to one or more sophisticated institutional buyers, with the major investors in the market being the US and UK insurance companies. UK insurance companies, like M&G and Aviva UK, are very active in the Sterling private bond market. The typical size range for a private placement bond is in the region of £25m to £500m.

In contrast to the public market, the bonds cannot be exchange-traded after issue. As such, private placement issues generally tend to attract an illiquidity premium and as such, have higher spreads and price slightly higher than in the public bond market.

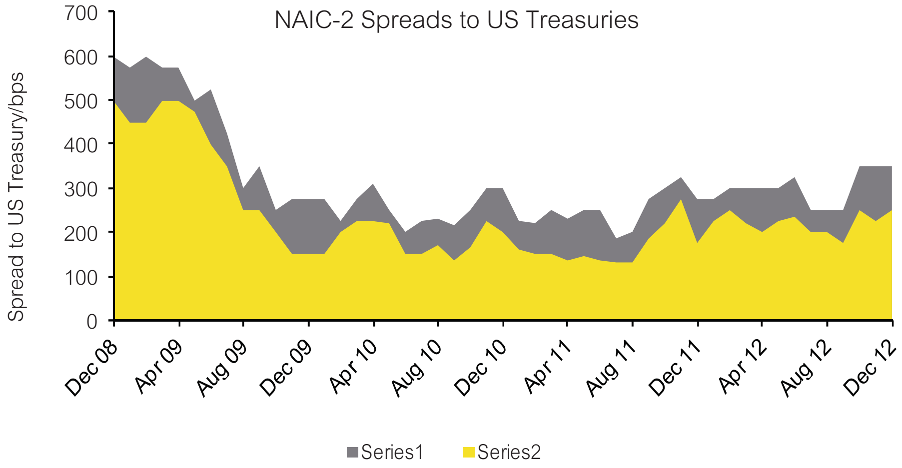
In the private placement market there will typically be a smaller number of investors and they will have a direct relationship with the issuer, allowing for a more bespoke negotiation of structure and terms. Furthermore, the issuance could also be kept private and not disclosed to the public market.

Due to the lack of rating requirements and not being listed on any exchange, a much lower level of ongoing disclosure is required than in the public bond market, however the pricing tends to be more expensive than a public bond. Whilst a public credit rating is not essential, the bonds would receive a credit designation from the National Association of Insurance Commissioners ('NAIC', the US insurance regulator) if any US investors took part in the deal. There is also the option to seek designation from the NAIC before the bonds are issued.

FIGURE 39 – NAIC-1 NEW ISSUE USPP SPREADS TO US TREASURIES



## FIGURE 40 – U.S. PRIVATE PLACEMENT ISSUANCE VOLUMES




Issuance in the U.S. Private Placement Market is limited and is infrequent from sovereign entities.

Sovereigns and sub sovereigns, including British overseas territories, have not ventured into the private placement market very frequently. The most recent was in 2009.

Sovereign linked or sovereign backed corporates have accessed the private placement market in the recent past including JT Group Limited in the Summer of 2012. JT Group Limited issued £51m of notes in two tranches, £31m of 3.86% 2019 notes and £20m of 4.48% 2022 notes.

Pricing in the private placement market is likely to be slightly wider (more expensive) than the public bond market to compensate investors for the lack of liquidity. From an issuer's perspective however, the transaction costs involved with a private placement are lower than those of a public bond deal.

Spreads in the private placement market have tightened (become less expensive) over time with spreads for a strong AA rated entity currently ranging from 150–200bps.

## FIGURE 41 – PRIVATE PLACEMENT MARKET COMPARABLES

| Date | Issuer | Rating (M, S&P) | Amount (US$m) | Tenor (years) | Coupon | Spread (T+bps) |
|---|---|---|---|---|---|---|
| Nov-09 | Government of Bahamas | A3, BBB | 300 | 20 | - | T+275 |
| May-09 | Government of Bermuda | Aa2, AA | 160 | 5<br>7<br>10 | 6.550%<br>6.980%<br>7.380% | T+450<br>T+425<br>T+425 |
| Sep-08 | Washington State Investment Board | NR, NR | 625 | 3 | - | T+225 |
| Dec-07 | Commonwealth of Pennsylvania | NR, NR | 27 | 24 | - | T+160 |
| Nov-07 | Government of Bermuda | Aa2, AA | 140 | 15 | - | T+150 |

### Structure considerations

The majority of investors are US based and are providers of US Dollar denominated funds. Some will offer a cross currency swap. Such an approach would, however, require “swap breakage indemnification”. In the event of early repayment by the borrower, investors use the indemnification to protect themselves from losses arising on the unwinding of interest rate and cross currency swaps initially taken out to provide Sterling funding.

Medium to small US based investors currently have limited appetite for undertaking cross-currency swaps, however large investors are very capable of undertaking this type of structure, including London based US investors. Additionally, there have been a few instances where some investors are willing to forgo swap breakage indemnification in order to participate in issues they feel to be particularly attractive. This is achieved through the use of a counterparty, thus eliminating the need for protection on unwind.

From Jersey’s point of view a sterling denominated bond presents both less risk and lower cost.

## Project Finance

### Project finance could potentially be raised against the specific assets being financed

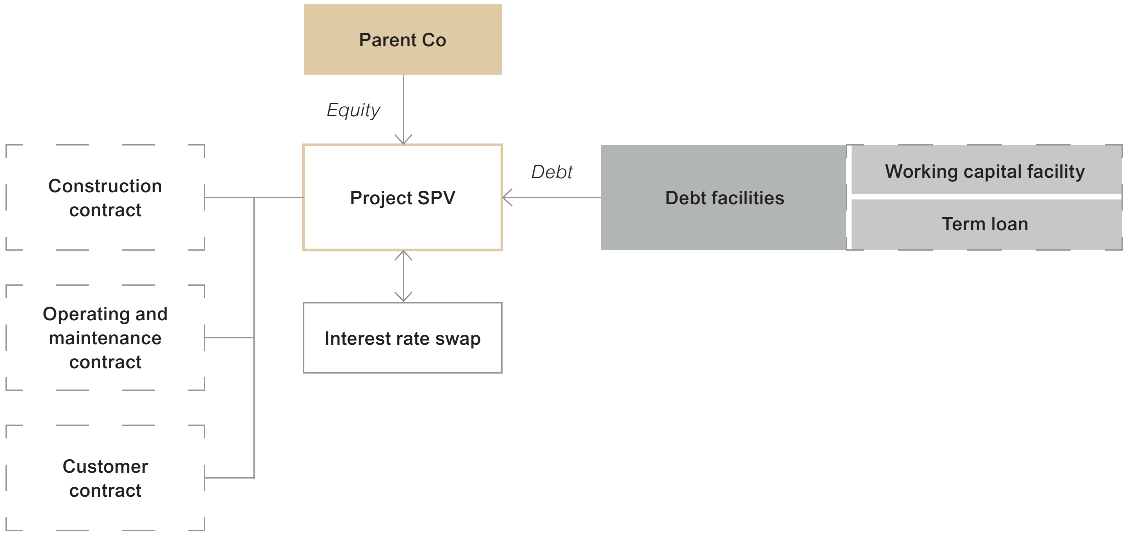
A secured project finance facility is also a potential source of finance for the capital projects where funding profile and repayment is matched to the specific cash needs and flows of a specific project.

A traditional project finance structure is outlined below and involves a ‘Project Company’ special purpose vehicle (‘SPV’) being set up as the borrowing entity, as well as the contracting entity, for construction contracts and customer contracts. The terms available to the SPV are based on the profile and cash flow of the project and not necessarily the underlying corporate credit quality.

If the States of Jersey were to pursue a project finance structure, a guarantee from the States of Jersey to the SPV would help significantly lower the cost of debt.

Project finance debt can be provided by banks (as has traditionally been the case) or by an institutional lender. Aviva, for example, has recently provided debt in a number of public sector infrastructure deals.

FIGURE 42 – A TYPICAL SPECIAL PURPOSE VEHICLE STRUCTURE FOR FINANCING PROJECTS




### Project finance facilities allow for more bespoke matching of project cash flow profiles to drawing of finance

A disadvantage of financing a project with a bond solution is that the typical phased capital requirement of a project does not align with the immediate drawn nature of a bond financing. A negative cost of carry may therefore be incurred if finance is drawn down and funds remain in a bank account, earning a lower rate of interest than the cost of borrowing.

A project finance structure would allow a gradual draw down of funds and therefore interest is only incurred as and when the capital requirement arises. The portion of the facility that remains undrawn would be subject to a non-utilisation or commitment fee.

FIGURE 43 – PROJECT FINANCE MARKET COMPARABLES

| Date | Project | Debt raised (£m) | Tenor (Years) | Margin (bps) | Mandated Lead Arrangers |
|---|---|---|---|---|---|
| Oct-12 | Avon & Somerset Police | 76 | 26 | - | Aviva |
| Aug-12 | Sheffield Highways | 212 | - | - | Lloyds, NordLB, KfW, Sumitomo Mitsui |
| Aug-12 | Hounslow Highways | 110 | 24.5 | 250 | Bank of Tokyo Mitsubishi, DZ Bank, KfW, Sumitomo Mitsui |
| Aug-12 | University of Essex Student Housing | 50 | 35 | - | Aviva |
| May-12 | Essex Waste | 165 | 26 | 350-400 | Sumitomo Mitsui, BayernLB, NordLB |
| May-12 | Lambeth Myatts Field North Housing | 72 | 24 | - | NordLB, Co-operative, NAB |
| Apr-12 | Barnsley Doncaster and RotherhamResidual Waste | 90 | 23 | 250-300 | Lloyds, Sumitomo Mitsui |
| Feb-12 | Nottingham Trent University Accommodation | 45 | 5 | - | RBS |
| Feb-12 | University of Reading Accommodation | 186 | - | - | Aviva |
| Feb-12 | Norfolk Waste | 90 | 25 | 305-340 | RBS, Lloyds, Sumitomo Mitsui |
| Dec-11 | Kirklees Social Housing | 79 | 22 | 235-255 | NordLB, Co-Operative, Nationwide |
| Nov-11 | Salford and Wigan Schools | 75 | 27 | 275 | NordLB |

Impending regulatory reform (in the form of Basel III) combined with volatile wholesale funding markets are affecting bank appetite for long term Project Financing. As a result, margins are creeping up with c.25 year funding costing over 350 bps in some cases.

From The States point of view this is not, therefore, the most efficient borrowing option.

## Bank Finance

Traditional bank finance is used by sovereign entities, but commonly by those with a weaker credit profile than the States of Jersey.

High investment grade sovereign entities are infrequent borrowers in the bank market. Recent loan funding in Europe has stemmed from nations at the centre of the Eurozone crisis, namely Spain and Portugal. Developing economies that do not have ready access to the capital markets have also turned to the bank market for support.

## FIGURE 44 – BANK LOAN MARKET COMPARABLES – SOVEREIGNS

| Date | Borrower | Rating (M, S&P, Fitch) | Currency | Form | Debt raised (m) | Tenor (Years) | Margin (bps)1 | Mandated Lead Arrangers |
|---|---|---|---|---|---|---|---|---|
| Nov-12 | Republic of Macedonia | NR, BB, BB+ | EUR | Term | 250 | 7 | N/D | - |
| Oct-12 | Diputacion de Vizcaya | Baa2, BBB+, AA | EUR | Term | 72 | 7 | N/D | BBVA, Kutxabank |
| Oct-12 | Republic of Ghana | NR, B, B+ | USD | Term | 162.6 | 12 | N/D | Citi, JP Morgan |
| Sep-12 | Republic of Angola | Ba3, BB-, BB- | JPY | Term | 30,800 | 8 | N/D | Japan Bank for International Cooperation, Bank of Tokyo Mitsubishi |
| Sep-12 | Republic of Angola | Ba3, BB-, BB- | JPY | Term | 30,200 | 8 | N/D | Japan Bank for International Cooperation, Bank of Tokyo Mitsubishi |
| Jun-12 | Province of Quebec | Aa2, A+, AA- | CAD | RCF | 3,500 | 3 | N/D | CIBC, RBC, TD |
| May-12 | Republic of Kenya | B1, B+, B+ | USD | Term | 600 | 2 | 475 | Standard Chartered, Citi, HSBC, PTA Bank |
| Feb-12 | Dubai | NR, NR, NR | USD | Islamic | 137 | 6 | N/D | Deutsche Bank, Citi, HSBC |
| Feb-12 | Dubai | NR, NR, NR | USD | Islamic | 137 | 6 | N/D | Deutsche Bank, Citi, HSBC |
| Feb-12 | Dubai | NR, NR, NR | USD | ECA | 401 | 13 | N/D | Deutsche Bank, Citi, HSBC |
| Nov-11 | Diputacion de Vizcaya | Baa2, BBB+, AA | EUR | Term | 168 | 8 | 340 | Banco Guipuzcuano, BBVA, Bilboa Bizkaia Kutxa, Caixabank, Caja Laboral, Ipar Kutxa |

Due to the Eurozone debt crisis, banks have experienced an increase in their own cost of finance, driving loan margins upwards. Margin increases, however, to an extent been mirrored by falls in LIBOR and EURIBOR rates.

However, requirements on tenor are far more restrictive with the tenor available in the bank market being much shorter than the capital markets. The sovereigns that have accepted shorter term bank financing tend to be driven by an inability to access the capital markets (typically due to lack of investor appetite due to concerns over credit strength).

The requirement to hold more Tier 1 capital has resulted in capital constraint for banks, reducing available capital and lending capabilities.

Jersey's financial position and strong balance sheet means that the Island has more cost effective means of borrowing than bank debt for funding these three major capital projects

## Summary of the Suitability of Funding Markets

A number of factors have been considered when assessing the suitability of funding markets for the States of Jersey

The following factors were considered for each funding market.

### FIGURE 45 – A SUMMARY OF THE SUITABILITY FOR JERSEY OF DIFFERENT FUNDING MARKETS

| Considerations | Relevance to the States of Jersey | Conclusion |
|---|---|---|
| **Currency** | As the States of Jersey generates a large portion of its revenue through taxation, which is denominated in Sterling, raising debt in Sterling avoids costs associated with cross-currency swap agreements. Therefore, raising debt in Sterling is deemed more suitable for the States in Jersey. | Direct Sterling most suitable |
| **Financing requirement** | The capital requirements of the three major projects is significant. (Please note that borrowing is only one of the funding options). | Market depth of up to £250m may be required. |
| **Tenor** | A long dated issuance is appropriate to fund the long term nature of the projects being financed. | 10–40 years. |
| **Coupon type** | A fixed coupon (interest rate) provides certainty over interest payments and avoid costs associated with swap agreements. Therefore, a fixed coupon is deemed more suitable for the States of Jersey as it protects against fluctuations in interest rates. | Fixed rate. |
| **Repayment** | The projects being funded are not expected to generate significant cash for principle repayment. However, the States is very unlikely to want to adopt the approach that many governments take and roll over debt from one loan to the next. The States will plan for the repayment of debt by building a fund so as to repay the debt at the end of the period. | Bullet structure with a separate fund built up over time to repay the debt. |

The markets reviewed are summarised below for their suitability against the States of Jersey's requirements

### Public bond market

The public bond market provides the opportunity to raise funds for tenors ranging from as short as 3 years to as long as 50 years.

The appetite for bonds and the success of an issuance in the public market is dependent on a clear communication of the credit proposition and a coherent rationale for the proposed issuance.

Therefore, it would be important that the States of Jersey clearly communicates its credit profile to the market. As a new issuer accessing the public bond market, a public credit rating would help the States of Jersey present its credit profile and position itself amongst its peers. Furthermore, it would also facilitate the achievement of a more competitive coupon rate (interest rate) than an unrated bond.

The Sterling public bond market provides sufficient capacity to raise the amount required by the States of Jersey to meet its funding needs, in the currency required. It also offers the States of Jersey the opportunity to access long term bullet maturity, fixed rate finance at historically low levels.

The Treasury view, informed by advice from Ernst & Young, is that the rated public bond market is the suitable option to meet the States of Jersey's requirements for borrowing, provided that the States is minded to use borrowing as a means of funding infrastructure investment. The project most suited to being funded from borrowing is Housing because the rental income stream can be used to repay debt.

### Retail bond market

The average deal size achieved in the retail bond market since the beginning of 2012 is c.£110m, which is below the debt financing requirement of the States of Jersey.

Furthermore, the maximum tenor achievable in the retail bond market is c.10 years. Individual savers (the buyers of retail bonds) have different priorities to institutional investors and are less likely to want to lock up funds for the long term.

A retail bond, therefore, is not likely to be a suitable option to provide the States of Jersey with the capital and tenor required.

### Private placement market

The private placement market provides the States of Jersey with the opportunity to raise the quantum required for durations of up to 30 years at a cost of Gilts+150–200bps.

Although the private placement market does not have any public rating requirements and has less onerous disclosure requirements than the public bond market, private placements price slightly wider (are more expensive) than public bonds. As a result of this, sovereign entities tend to access the public bond market rather than the private bond market where tighter (cheaper) pricing can be achieved, due the depth of secondary market liquidity (the extent to which bonds can easily be bought and sold).

Furthermore, raising the required funds in Sterling from US based investors may also prove challenging due to the likely requirement for cross currency swaps.

Therefore, due to the higher cost of finance and the potential challenges associated with raising the required funds in Sterling (depending on the amount sought), the private placement market is not likely to be the most suitable option for the States of Jersey's financing requirements.

### Project finance

The amount of capital banks are required to raise to comply with Basel III will depend on the profile of their lending activities, with credit risk, liquidity, and tenor all playing a part in determining the capital weighting of each exposure. Project finance lending is expected to attract large capital weightings due to the long tenor, relative illiquidity and bespoke nature of each financing.

As a result, bank appetite for project finance debt is reducing, with prices rising, and tenors decreasing.

Whilst tenors of up to 25 years may be achievable, margins on this tenor may be higher than other funding markets.

Project finance requires the underlying assets to have strong cash flows associated with them. This is not the case for the Hospital Project or the Housing Project in earlier years.

Therefore, project finance would be more expensive than bond finance and would also prove challenging to access in the current market. It is not likely to be a suitable form of financing for the States of Jersey.

### Bank market

Bank market finance can be simple to arrange, provides flexible drawdown profiles and is also less onerous as there are no credit rating requirements. In addition, the bank market also facilitates raising the required amount of funds in Sterling.

However, despite the benefits of this source of funding, the tenor available in the bank market is much shorter than that available in the capital markets. The shorter-term nature of this funding source would not meet the States of Jersey's requirement for long term financing.

Furthermore, interest on bank market funding is generally floating with reference to a relevant interbank rate. As such, there is likely to be uncertainty associated with debt servicing costs. This uncertainty could be hedged through swap agreements. However, there would be costs associated with entering into swap agreements.

The bank market could be a suitable short-term financing option for the States of Jersey, but is unlikely to meet its medium and long term requirements.

## Summary of Funding Market Suitability

### FIGURE 46 – ASSESSMENT OF FUNDING MARKET SUITABILITY

| | Public Bond (rated) | Public Bond (unrated) | Retail Bond (listed) | US Private Placement | Project Finance | Bank debt |
|---|---|---|---|---|---|---|
| Currency - GBP | ✓ | ✓ | ✓ | ✗ | ✓ | ✓ |
| Liquidity capacity | ✓ | ✓ | ✗ | ✓ | ✓ | ✓ |
| Tenor - 10 to 40 yrs | ✓ | ✓ | ✗ | ✓ | ✓ | ✗ |
| Benefit from a credit rating | ✓ | ✗ | ✓ | ✓ | ✗ | ✗ |
| Direct inflation-linked | ✓ | ✓ | ✓ | ✓ | ✗ | ✗ |
| Coupon type – fixed | ✓ | ✓ | ✓ | ✓ | ✗ | ✗ |
| Maturity type – bullet | ✓ | ✓ | ✓ | ✓ | ✗ | ✗ |
| Transaction costs (upfront fees) | ✓ Lower than the bank market | ✓ Lower than the bank market | ✓ Lower than the bank market | ✓ Lower than the bank market and the public | ✗ Higher than the public bond market | ✗ Higher than the public bond market |
| Transaction costs (ongoing costs) | ✗ High transaction costs | ✗ High transaction costs | ✗ High transaction costs | ✓ Lower than the public bond market | ✓ Lower than the public bond market | ✓ Lower than the public bond market |
| Disclosure requirements | ✗ Onerous disclosure requirements | ✗ Onerous disclosure requirements | ✗ Onerous disclosure requirements | ✓ Less than the public bond market | ✓ Less than the public bond market | ✓ Less than the public bond market |
| Pricing | ✓ Lowest pricing achievable | ✗ Wider than the rated public bond market | ✗ Wider than the institutional bond market | ✗ Higher than the public bond market | ✗ Higher than the private bond market | ✗ Higher than the rated public bond market |
| Suitability for Jersey | ✓ Can provide tenor and quantum of funds sought | ✗ Can provide tenor but pricing likely to be higher than a rated public bond | ✗ Unlikely to offer capacity and tenor required | ✗ Pricing likely to be higher than public market | ✗ Likely to be costly, complex and time consuming | ✗ Unlikely to offer tenor required |

# 14. Funding Strategy – Servicing the Debt

## Indicative Interest Costs

Should a bond be issued, the States of Jersey would need to service its debt annually.

The pricing below is undertaken based on Gilt rates and spreads as at 14 February 2013.

Assuming that the States of Jersey receives a 'AA+/Aa1' credit rating, indicative assumptions on pricing are set out in the table below.

FIGURE 47 – THE PRICING OF UK GILTS FOR DIFFERENT TENORS (FEB 2013)

| | 10 year | 15 year | 20 year | 25 year | 30 year | 40 year |
|---|---|---|---|---|---|---|
| UK Gilt rate (%) | 2.10% | 2.65% | 3.00% | 3.25% | 3.34% | 3.47% |
| Credit spread for a AA+ rated entity | 65–100 bps | 65–105 bps | 70–110 bps | 75–120 bps | 80–125 bps | 80–125 bps |
| Total coupon (%) | 2.7%–3.1% | 3.3%–3.7% | 3.7%–4.1% | 4.0%–4.4% | 4.1%–4.6% | 4.3%–4.7% |

It must be noted that the pricing in the above table will move over time as Gilt rates and spreads move.

Should the States of Jersey choose to issue an unrated bond, the credit spreads would increase (become more expensive) from those shown in the table above, the pricing differential varies at different points in the market but may be in the range of 20–30bps.

FIGURE 48 – INDICATIVE INTEREST COSTS FOR LONG TERM BORROWING

| | 10 year | 15 year | 20 year | 25 year | 30 year | 40 year |
|---|---|---|---|---|---|---|
| Assumed debt (£ million) | £200 million | £200 million | £200 million | £200 million | £200 million | £200 million |
| Annual interest costs (£ million) | £5.5–£6.2 million | £6.6–£7.4 million | £7.4–£8.2 million | £8.0–£8.9 million | £8.3–£9.2 million | £8.6–£9.4 million |

Note that the Housing Business Case (R15/2013) fully provides to meet the cost of borrowing from rental income at higher rates (a prudent 5% was assumed) than are presently achieveable.

## Tenor Considerations

A range of factors will influence which tenor(s) are deemed to be most appropriate.

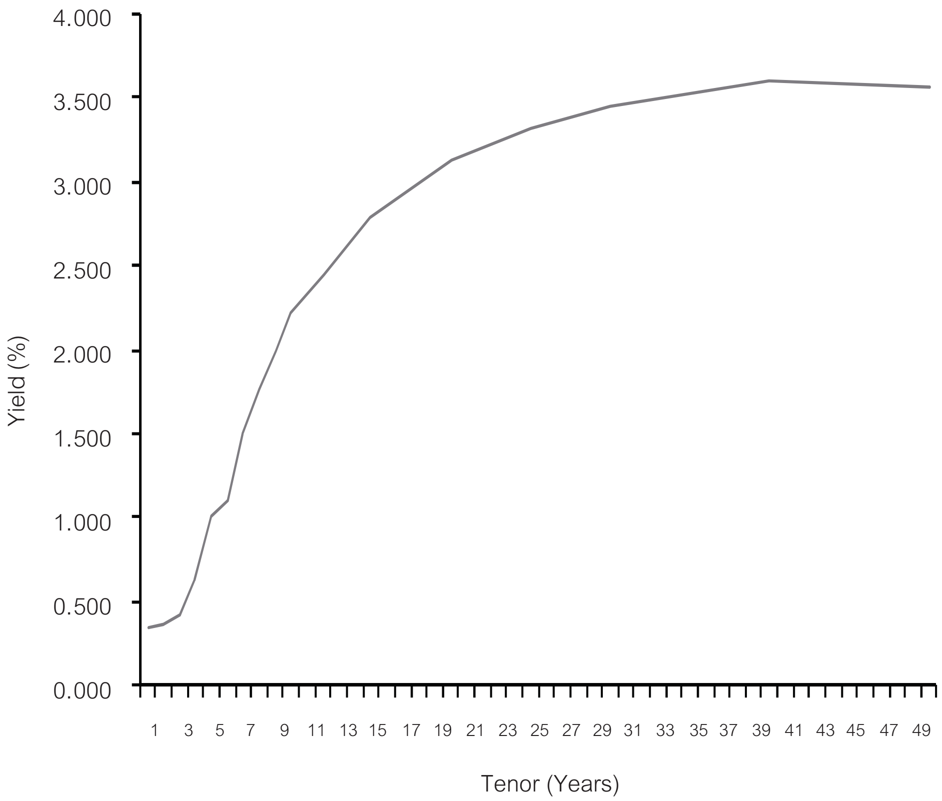
Bonds are priced with reference to an underlying benchmark rate. In the Sterling market this benchmark rate is the Gilt yield at the maturity that most closely matches the maturity of the bond being priced.

Gilt yields change constantly as they are very liquid instruments that are traded very frequently and in high volumes. The yield of Gilts across a range of maturities (the yield curve) is shown in the chart below. Please note that this curve changes constantly according to market conditions.

In order to recompense investors in fixed interest instruments for investing their capital for a longer period of time, the longer the tenor of an instrument, the higher the coupon (in general). Therefore opting for a longer tenor instrument will tend to translate into a higher coupon. This relationship between tenor and yield can be seen in the Gilt yield chart, however the difference reduces at the longer end of the curve.

Investor appetite will vary across the range of tenors. Generally, lower credit quality issuers in a would typically only find support from investors for issuances at shorter maturities. Strong credits that will be in existence far beyond the life of the bond with a reasonable level of certainty like the States of Jersey, are able to access longer maturities.

FIGURE 49 – THE UK GILT YIELD CURVE




Investors will also consider the liabilities that they are seeking to match with the income from the bond coupons. Many bond investors are insurance or pension companies with an exposure to long term liabilities. Therefore they will seek to hold an allocation of longer tenor assets to match their long tenor liabilities.

There are relatively few long tenor bonds issued when compared to more common tenors around the ten year mark. Therefore new supply at this end of the yield curve gives investors an opportunity to diversify their current holdings.

PECRS, JTSF and the CIF could potentially invest in a bond issued by the States of Jersey as part of their managed portfolios. The tenor requirements of these funds, which are driven by the liabilities they are looking to match, would also need to be considered. Independent investment advice from Mercers and Aon Hewitt is provided to these Funds. However, the Bonds would be publicly traded and PECRS, JTSF and CIF would have no obligation to hold them but could make a commercial choice based on independent advice.

We would expect strong support for a longer tenor offering for the States of Jersey. An example of a recent long tenor debut Sterling bond that received very strong support was the £350m issuance from Cambridge University in October 2012. The deal was for 40-year notes which were rated Aaa/stable by Moody's which priced at Gilits+60bps.

***The proposed use of borrowing through the issuance of a public rated bond to meet the spending needs of the three major capital projects is limited to £250m for housing purposes.***

## Indexation Considerations

There is a market for public bonds with a repayment profile linked to inflation indices.

Issuing index linked debt allows issuers to match repayment obligations to index linked cash inflows.

The market for index linked government debt is well developed for the largest and most frequent issuers. However index linked bonds from debut and smaller issuers are extremely uncommon.

Of the smaller high grade sovereign nations detailed in the table below, none have inflation linked bonds outstanding. In comparison, only 17% of the total amount of all UK government bonds are index linked.

FIGURE 50 – SMALLER JURISDICTIONS TEND NOT TO ISSUE INDEX LINKED BONDS

| | Bonds outstanding (Sterling equivalent) | % nominal | % index linked |
|---|---|---|---|
| **Isle of Man** | £260m | 100% | 0% |
| **Bermuda** | £610m | 100% | 0% |
| **Hong Kong** | £5,419m | 100% | 0% |
| **Singapore** | £42,209m | 100% | 0% |
| **United Kingdom** | £1,237,384m | 83% | 17% |

As there is inherent protection against certain risks in an index linked bond, the rewards tend to be equally reduced with index-linked bonds usually offering very low returns. As a result, the investor pool for index-linked instruments is small and it is only the largest, most prolific, well-known issuers that are able to access the small index linked investor base.

Ernst & Young advise that a lower risk option for the States of Jersey would be to target a much wider pool of potential investors through a public bond.

### States of Jersey Funds

Borrowing from external sources is not the only option for the States. The States has Funds of its own that are presently invested almost entirely off-Island. There is scope for Funds, in accordance with their own investment strategy, to invest in projects that are on-Island and that have a risk and return profile consistent with the Fund's own investment strategy.

The States of Jersey has a number of funds each with its own legal framework, defined purposes and governance arrangements. These funds include: The Common Investment Fund (in which both the Social Security Reserve and the Strategic Reserve are invested), The PECRS Pension Fund and the JTSF Pension Fund. These Funds amount to around £4 billion in total.

Each of these Funds has its own published Investment Strategy and has investment advice on the development of that strategy from consultants. Mercer, for PECRS and JTSF and Aon Hewitt for The Common Investment Fund. The investment strategies are implemented by the States Treasury.

Each of these strategies has a strategic allocation to traditional asset classes such as government and corporate bonds and equities and also has an allocation to alternative investments such as property and infrastructure. To date this £4 billion has been invested all over the world: in sovereign and sub sovereign government bonds and corporate bonds with high credit ratings and in UK and global equities.

It makes financial sense to all parties to give these Funds the option of a direct infrastructure investment in Jersey with a long term duration at a market rate of interest. It is important for the independence of these Funds that this is an option, not an obligation. This could help reduce the costs to the public purse and be of no detriment to these Funds providing an interest rate and terms are agreed that the Funds' independent investment advisers (Aon Hewitt and Mercer) are satisfied with and that the interests rates provide fair value and an appropriate balance between risk and return.

This option has already been used successfully to provide funding to Jersey organisations that are established with their own constitutions and operate independently of the States. For example, the Parish of Trinity has an investment of £6 million from the Currency Fund to facilitate the development of affordable homes in the Parish. Legal agreements, developed for Treasury by the Law Officer's Department, are in place to set out the terms for the investment. The terms include the purpose of the investment, the rate of return and the repayment terms. In this instance the investment was made from the Currency Fund. This borrowing will be repaid by Trinity by 2016 or sooner and the Parish will benefit from new affordable housing that would otherwise have cost substantially more.

The Table below sets out some of the States' major Funds and gives an indication of the amounts that could be made available for infrastructure investment. These are indicative only.

***The proposed use of infrastructure investment to meet the spending needs of the three major capital projects is limited to an investment in the Liquid Waste Strategy of £32m from the Currency Fund.***

FIGURE 51 – THE STRATEGIC ALLOCATION TO ALTERNATIVES IN STATES OF JERSEY FUNDS (INCLUDES INFRASTRUCTURE)

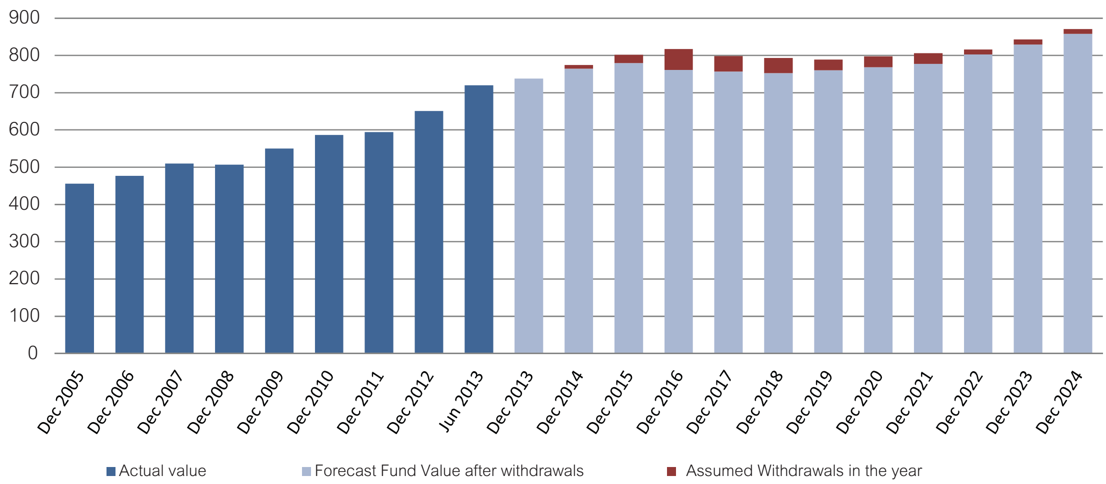
| | Strategic Reserve £'m | Stabilisation £'m | Social Security (Reserve) £'m | Health Insurance Fund £'m | Currency Fund £'m |
|---|---|---|---|---|---|
| **Fund Balances as at:** | | | | | |
| 31.5.13 | £718.0 | £1.1 | £1,101.0 | £76.3 | £88.4 |
| 31.12.12 | £651.0 | £1.1 | £962.1 | £70.1 | £90.5 |
| Amount of money held not for investment (i.e. cash buffer) | | | | | £2.0 |
| | | | | | |
| **Current Investment Strategy (R.117-2012 published 01.10.12)** | | | | | |
| Equities | 50% | | 80% | 40% | 20% |
| Alternatives (1) (2) | 10% | | 10% | | 60% |
| Bonds | 40% | 80% | 10% | 45% | 10% |
| Cash | | 20% | | 15% | 10% |
| | 100% | 100% | 100% | 100% | 100% |

Note: (1) Alternative investments in the Strategies are defined to include Infrastructure Investments.

Note the Housing Transformation project in relation to Financing approved by the States says that, £40m would be funded by an Internal Borrowing facility (R.15-2013 and R.132-2011) at 4% per annum, 20 years and the rest by way of external financing (R.15-2013). The Proposition within this Report now recommends funding all of the housing requirement from external borrowing through the issuance of a public rated bond with the debt, to be repaid from the rental income generated from the new properties.

The third possible source of funding for the three major capital schemes is the use of existing States' resources. This Report proposes that the funding for the hospital scheme of an estimated £297 million to be spent over the years 2014 to 2024 is drawn down from the Strategic Reserve Fund thereby meeting the cost of the hospital from the investment returns on the Fund. This means the Hospital project can be met with no new cost to the tax payer and without incurring debt. The hospital would be paid for in full by the time it was completed. The advantages of this are that by the time the hospital is built, the scheme can be fully funded with no new cost to the taxpayer and without the need for borrowing. The hospital costs would be fully met over the 10 years from the Strategic Reserve and leave no debt for future generations. The chart below illustrates how this would work and subsequent charts illustrate the sensitivities, showing what happens if investment returns are higher or lower and what if the spending actually occurs over a shorter 5 year time period rather than 10 years.

FIGURE 52 – PROJECTED STRATEGIC RESERVE FUND BALANCE (£'M) ASSUMING 5% INVESTMENT RETURN AND DRAWN DOWN OF £297M FOR THE HOSPITAL




## Strategic Reserve Balance

When considering this proposal, State Members may find it helpful to see the history of the Strategic Reserve Fund, and the amounts of Capital injected to create and build the Fund and the investment returns generated on it. The Tables and data below may assist.

The Strategic Reserve was created in 1986 with an initial capital injection of £10 million. In the years since the inception of the Fund a further £167 million has been transferred in and capital withdrawals totalling £60 million have been made, giving a net capital position of £117 million (Figure 53, see overleaf).

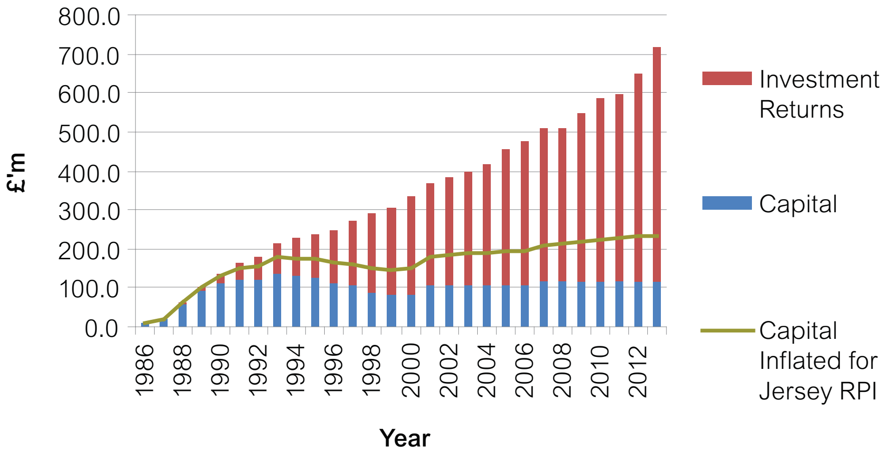
### FIGURE 53 – STRATEGIC RESERVE 1986–2013 (AS AT 31ST AUGUST) CAPITAL MOVEMENTS

| Year | Capital In £ | Capital Out £ | Net Capital Movement £ | Cumulative Capital £ |
|---|---|---|---|---|
| 1986 | 10,079,392 | - | 10,079,392 | 10,079,392 |
| 1987 | 10,000,000 | - | 10,000,000 | 20,079,392 |
| 1988 | 40,000,000 | - | 40,000,000 | 60,079,392 |
| 1989 | 30,000,000 | - | 30,000,000 | 90,079,392 |
| 1990 | 20,000,000 | - | 20,000,000 | 110,079,392 |
| 1991 | 10,000,000 | - | 10,000,000 | 120,079,392 |
| 1992 | - | - | - | 120,079,392 |
| 1993 | 17,095,832 | - | 17,095,832 | 137,175,224 |
| 1994 | - | (5,000,000) | (5,000,000) | 132,175,224 |
| 1995 | - | (7,000,000) | (7,000,000) | 125,175,224 |
| 1996 | - | (15,000,000) | (15,000,000) | 110,175,224 |
| 1997 | - | (5,000,000) | (5,000,000) | 105,175,224 |
| 1998 | - | (17,500,000) | (17,500,000) | 87,675,224 |
| 1999 | 3,000,000 | (10,500,000) | (7,500,000) | 80,175,224 |
| 2000 | 4,000,000 | - | 4,000,000 | 84,175,224 |
| 2001 | 23,000,000 | - | 23,000,000 | 107,175,224 |
| 2002 | - | - | - | 107,175,224 |
| 2003 | - | - | - | 107,175,224 |
| 2004 | - | - | - | 107,175,224 |
| 2005 | - | - | - | 107,175,224 |
| 2006 | - | - | - | 107,175,224 |
| 2007 | 10,000,000 | - | 10,000,000 | 117,175,224 |
| 2008 | - | - | - | 117,175,224 |
| 2009 | - | - | - | 117,175,224 |
| 2010 | - | - | - | 117,175,224 |
| 2011 | - | - | - | 117,175,224 |
| 2012 | - | - | - | 117,175,224 |
| 2013 | - | - | - | **117,175,224** |
| **TOTAL** | **177,175,224** | **(60,000,000)** | **117,175,224** | |

The investment returns on the Strategic Reserve since its establishment in 1986 amount to £599 million over the value of capital invested. The total balance of £716 million as at 31st August 2013 is therefore made up of £117 million in principle (capital) and £599 million of investment returns (interest).

If the capital of £117 million within the Strategic Reserve Fund were increased in real terms, in line with Jersey inflation, the capital element would be £230 million. Figure 54 illustrates this.

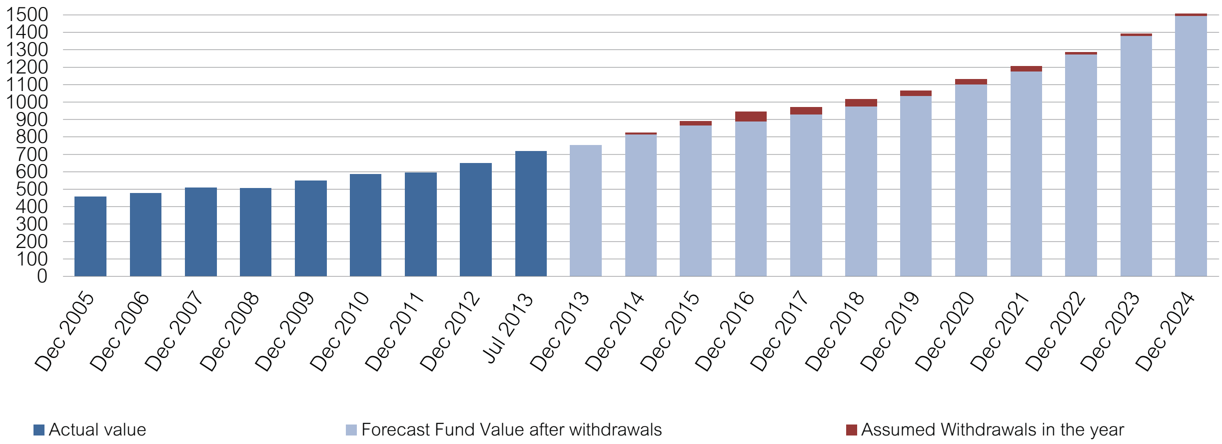
FIGURE 54 – STRATEGIC RESERVE CAPITAL AND INVESTMENT RETURNS




## DIFFERENT SCENARIOS FOR THE STRATEGIC RESERVE

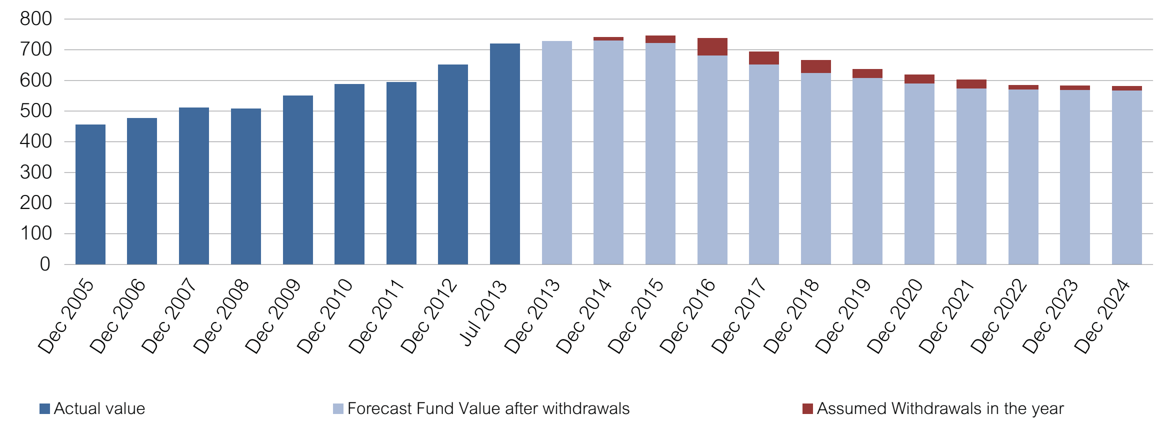
In July 2010 the Strategic Reserve balance was £550m and in July 2013 it is £720m – the compound average annual growth is 9.4% per annum. If this rate of growth were to continue and Treasury would not advise making a decision based on such ambitious investment targets being achieved, then the Strategic Reserve Fund would stand at the levels shown in the chart below. This is based on actual performance in the last three years but it is included only for illustration. Treasury recommends the decision to be taken on a prudent assumption of an average of 5% returns.

FIGURE 55 – PROJECTED STRATEGIC RESERVE FUND BALANCE (£'M) ASSUMING 9.4% INVESTMENT RETURN AND DRAWN DOWN OF £297M FOR THE HOSPITAL



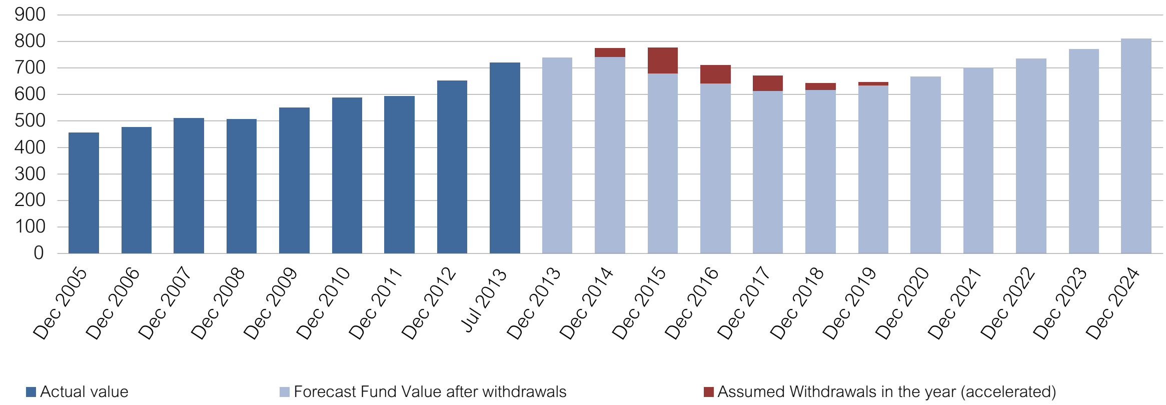
At the other end of the spectrum, if the Strategic Reserve Fund achieved only a long term average of 2% returns and £297m were drawn down to fund the hospital, the balance by 2024 would still be close to £600m and still well above the capital values inflated for Jersey RPI.

FIGURE 56 – PROJECTED STRATEGIC RESERVE FUND BALANCE (£'M) ASSUMING 2% INVESTMENT RETURN AND DRAWN DOWN OF £297M FOR THE HOSPITAL




The final sensitivity graph below shows what happens if the 5% annual growth assumption is used, but the hospital project proceeds much faster – in fact at twice the planned rate. The £297m for the hospital would then be drawn down over five years rather than the estimated ten years.

FIGURE 57 – PROJECTED STRATEGIC RESERVE FUND BALANCE (£'M) ASSUMING 5% INVESTMENT RETURN AND DRAWN DOWN OF £297M (ACCELERATED TO 5 YEARS) FOR THE HOSPITAL



## FIGURE 58 – HOUSING BORROWING – INDICATIVE COSTS

| | | | | |
|---|---|---|---|---|
| **Funding method (which includes the issuance costs)** | | | | |
| - Amount to Borrow | £207/250m | £207/250m | £207m | £43m |
| - Life of the bond | 20 years | 30 years | 20 years | 20 years |
| - Type of bond | Public bond with rating | Public bond with rating | | |
| - Gilt rate (valid 02/07/13) | 3.18% | 3.53% | | |
| - estimated coupon (valid 02/07/13) | 3.88% | 4.33% | 3.88% | 3.88% |
| - issuance date | | | 2014 | 2018 |
| | | | | |
| **Annual costs – interest costs** | | | | |
| first 10 years | | | 8,031,600 | 1,001,040 |
| year 11–20 | | | 8,031,600 | 1,668,400 |
| year 21–24 | | | | 1,668,400 |
| year 25–30 | | | – | – |
| year 31–34 | | | | |
| **Total cost of 20/30 years** | | | **160,632,000** | **33,368,000** |
| | | | | |
| **Average Annual charge to sinking fund (assumed 4.0% return pa, zero year 1 and the final year)** | | | | |
| first 10 years | | | 3,710,000 | |
| year 11–20 | | | 12,163,961 | 3,205,447 |
| year 21–24 | | | | |
| year 25–30 | | – | – | |
| year 31–34 | | – | – | |
| **Total cost of 20/30 years** | | | **158,739,610** | **32,054,470** |
| | | | | |
| **TOTAL COST PER ANNUM** | | | | |
| first 10 years | | | 11,741,600 | 1,001,040 |
| year 11–20 | | | 20,195,561 | 4,873,847 |
| year 21–24 | | | – | 1,668,400 |
| year 25–30 | | | – | – |
| year 31–34 | | | – | – |
| **Total cost of 20/30 years** | | | **319,371,610** | **65,422,470** |

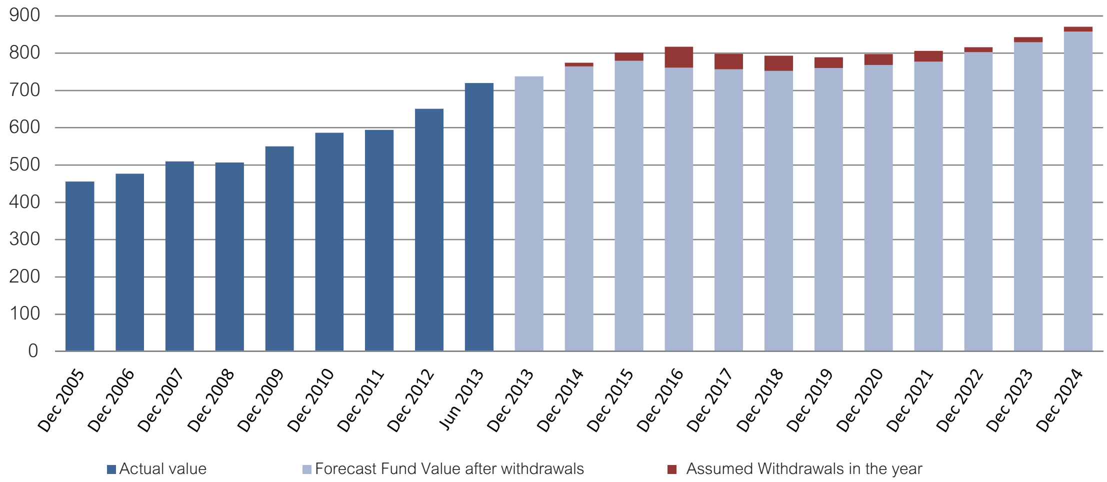
Notes

The Housing financial model currently assumes they can draw down the monies as they require and pay interest and also capital repayments. The Housing financial model is based on a 20 year repayment basis. Housing will draw on the funds raised from the bond issuances as and when they require it. Interest will only be payable by housing when funds are drawn down. Housing will pay into the sinking fund from year 9 onwards at variable amounts, but calculations have been prepared to ensure the funds are invested in the sinking fund to ensure full and final payment upon each maturity for each bound issued. If a bond is raised for 30 years, whilst it is not inline with housings model, there are would be additional interest cost however it provides the opportunity of cheaper financing for an extra 10 years.

# 15. Summary Of Proposals For Funding The Three Major Capital Projects

## Hospital Project – £297 million from the Strategic Reserve Fund Drawn As Required

FIGURE 60 – PROJECTED STRATEGIC RESERVE FUND BALANCE (£'M) ASSUMING 5% INVESTMENT RETURN AND DRAWN DOWN OF £297M FOR THE HOSPITAL




The proposed funding route means that:

- The Hospital costs would be fully met over the 10 years of development from the Strategic Reserve;
- There would be no debt for future generations;
- There would be no new cost to the taxpayer;
- The cost of the Hospital will be funded from the Investment Returns of the Strategic Reserve Fund; and
- The funding remains in the Strategic Reserve until it is needed and is fully invested so as to maximise investment return and minimise cost.

## Housing Project – £250 million by Public Rated Bond

Ernst & Young advise that of the external debt markets open to the States of Jersey, the public bond market is likely to provide the tightest pricing for long term debt capital.

Accessing the Sterling public bond market (with a public credit rating) offers a sensible and cost effective financing route for housing purposes and is recommended.

- Sterling bonds are priced in the public bond market with reference to a credit spread above UK Gilts, which are currently at historic lows.

- A public rating will increase transparency, give investors confidence, and allow a robust pricing argument to be constructed.

- The Housing Business Case (R15/2013) assumed that external borrowing would be used and fully provides for meeting the costs of principal and interest.

- The costs of repayment of the debt would be met from the housing rental income stream.

- The new Housing Company would have new assets (housing) on its balance sheet to offset the liabilities (debt).

## Liquid Waste Project – £29 million through Infrastructure Investment and Use of Existing Resources

The proposed sources for liquid waste are set out in the Table below.

### FIGURE 59 – FUNDING SOURCES FOR LIQUID WASTE

| | 2013 £'m | 2014 £'m | 2015 £'m | 2016 £'m | 2017 £'m | 2018 £'m | 2019 £'m | 2020 £'m | TOTAL £'m |
|---|---|---|---|---|---|---|---|---|---|
| TTS Rolling Vote | – | 4.0 | – | 4.0 | 4.0 | – | – | – | 12.0 |
| Main Capital Programme | – | 3.1 | – | 6.7 | 7.4 | 12.2 | 1.1 | – | 30.5 |
| Consolidated Fund | – | 3.0 | – | – | – | – | – | – | 3.0 |
| Infrastructure investment from currency fund | – | – | 21.2 | 7.8 | – | – | – | – | 29.0 |
| Existing resources | 0.5 | – | – | – | – | – | – | – | 0.5 |
| **Total required** | **0.5** | **10.1** | **21.2** | **18.5** | **11.4** | **12.2** | **1.1** | **–** | **75.0** |

The funding sources proposed and recommended for liquid waste are:

- a targeting of the existing rolling capital vote (£12m);

- an allocation within the traditional main capital programme (£34m); and

- an investment from the Currency Fund allocation to infrastructure (£29m) with interest and principle to be repaid by TTS from existing resources and operational cost savings generated by the new infrastructure.

The funding route means that:

- there is no external debt;
- the internal borrowing benefits the Currency Fund (say a 4% return against a cash return of only 0.8%);
- the borrowing cost and risk to TTS is minimised;
- there is not new cost to the taxpayer;
- there is no external debt added to the States' Balance Sheet; and
- it is an affordable option for TTS because the new infrastructure is more energy efficient and is cheaper to run.

# 16. Appendix A

## Better Health and Social Services

## A New Way Forward

The Health and Social Services Report and Proposition P.82/2012, approved by the States Assembly on the 23rd October 2012, sets out the vision of an integrated care model and a programme of change that will meet the challenges facing the Island's future Health and Social Services.

Central to the development of this vision is the need to have an acute general hospital which is fit for purpose, capable of sustaining the acute care provision requirements for the population and complements the integrated care strategy being developed for Jersey.

Consultation has shown that Islanders want Health and Social Services that are:

**'Safe'** – while many health interventions involve inherent levels of risk, that patients and service users should not be exposed to an undue level of risk.

**'Sustainable'** – that services should be organised in a way that is not vulnerable to change in the short term.

**'Affordable'** – that the model of services represents value for money relative to other potential model.

P.82/2012 makes clear that new hospital capacity will be required within 10 years.

## Existing Hospital – Condition and Development Potential

WS Atkins were appointed to review the condition and development potential of the existing General Hospital. Their report confirmed the following:

- The total floor area of the combined hospital buildings (circa 38,500m2) is about 60% of that needed for a full new hospital to modern standards (63,600m2).
- A condition assessment carried out in 2008 assessed the majority of the building as being in category C or D – i.e. needing significant investment or replacement.
- Poor configuration and/ or condition meant that some of the existing buildings have limited potential for clinical use or development in a future hospital.
- The layout of the hospital means that there is little opportunity to intensify uses on the current plot and any development would need to be in a phased manner.

WS Atkins concluded that a complete redesign and increase in the size of the existing Hospital is required, not only to meet the future acute clinical needs of the growing population of Jersey, but also to address the increase in space standards required to meet current best clinical, spatial and operational practices.

## 100 Single Bed Rooms

FIGURE 61 – EXISTING HOSPITAL – 6 BED WARDS

## 21st Century Theatres

FIGURE 62 – EXISTING HOSPITAL – 1980S THEATRES

## 21st Century Laboratories

FIGURE 63 – EXISTING HOSPITAL – 1970S LABORATORIES

## Ageing Population and Activity Analysis

WS Atkins reviewed hospital activity, service development plans and proposals for delivering more health services in the community to establish the scale of future hospital capacity required.

Assuming 2011 Census projections and that proposals within P.82/2012 are successfully implemented, new hospital capacity of circa 300 beds will be required.

Pressures on bed numbers will grow before new hospital capacity is available such that by 2017 up to 50 additional beds will be required to avoid permanent bed crisis.

## Site Search

Jersey Property Holdings were commissioned to undertake a spatial assessment for new Hospital capacity to inform P.82/2012.

- The Planning and Environment Geographical Information System was employed for the subsequent site search.
- A cross-Departmental Officer group reviewed 24 potentially suitable sites and identified a long-list of 11 sites for review by WS Atkins International – a respected hospital master-planning consultant.
- All sites of sufficient footprint (18,000m2) within or adjacent to the Built Up Area were reviewed against set criteria including green and brownfield sites.
- Potential sites suggested by the Minister for Planning and Environment were also reviewed.
- Potential sites were drawn up and evaluated by WS Atkins using cost, benefit and risk criteria. WS Atkins recommend a short-list of 3 sites.

The Ministerial Oversight Group for health transformation, having considered all of the alternatives, accepted the Officer recommendation that the existing general hospital site offered the best location for key investment in future hospital capacity.

## Model of Care

Architects appointed to develop the future hospital identified that there is insufficient footprint on the current hospital site to develop all of the new services needed.

Planning restrictions are in place – for example on the listed Granite Building -and massing restrictions limit the ability to develop the larger building needed.

Investing in one site would also not maximise the benefit of the available investment and would result in a lengthy complicated construction programme that would cause considerable inconvenience to patients.

A new model of care is therefore proposed that would separate emergency / in-patient overnight care from out-patient day care.

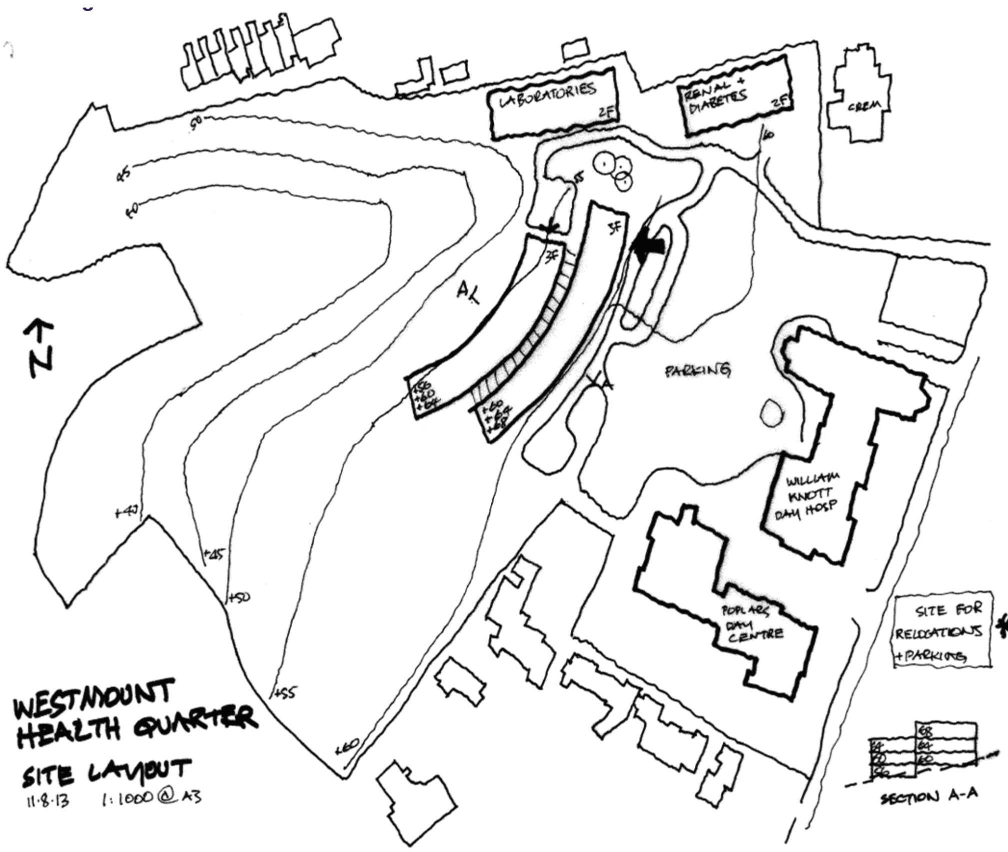
A brand new out-patient building would be developed at the Overdale Hospital integrated with the existing rehabilitation and social services to form a Westmount Health Quarter.

This would free up vital space to allow new theatre, bed, Accident and Emergency and children’s bed capacity at the existing hospital site.

## Westmount Health Quarter

The design of the Westmount Health Quarter is for a modern, high quality out-patients building within the excellent healing environment at Overdale. The existing Westmount Health Centre, William Knott and Poplars buildings will be retained.

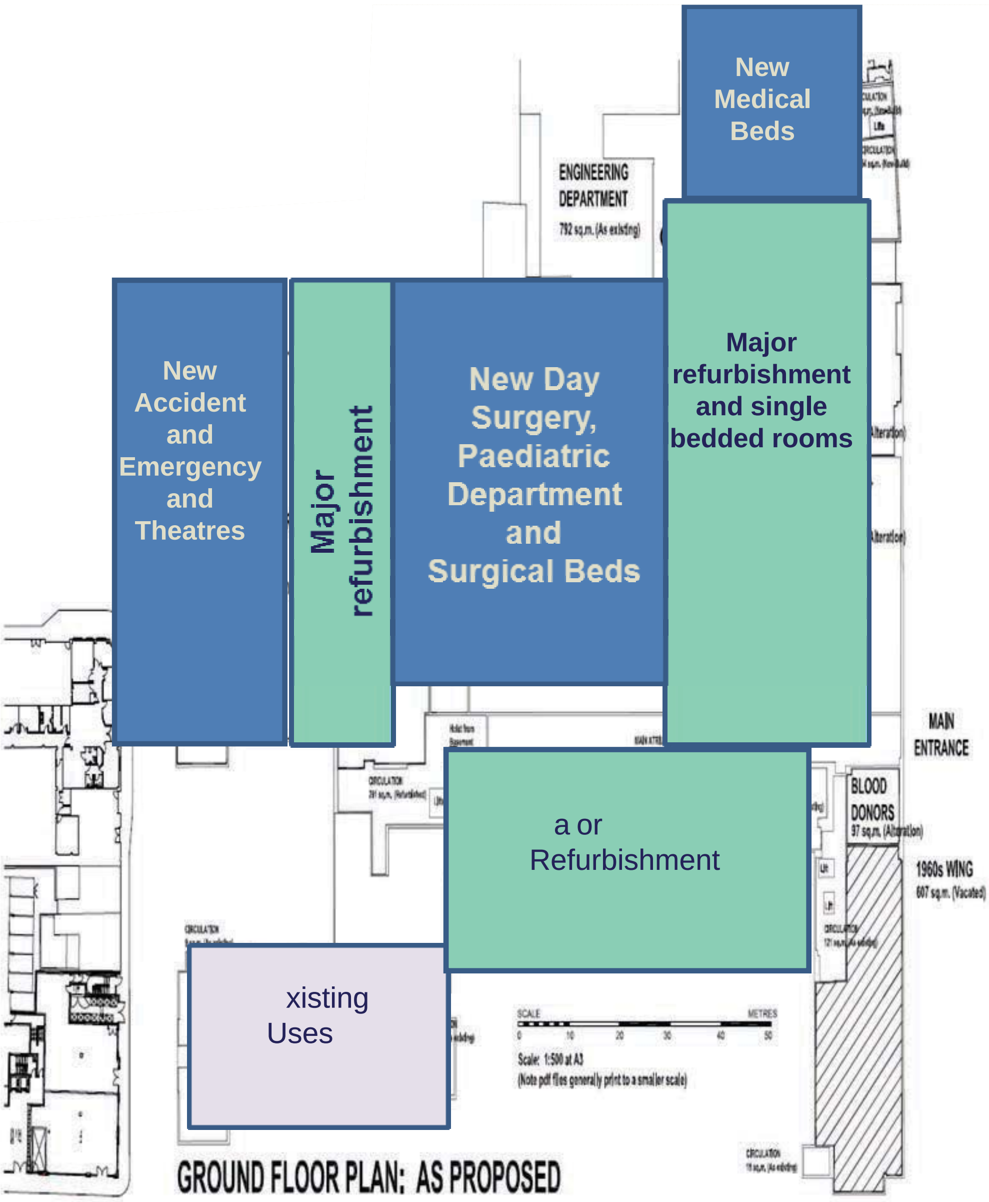
FIGURE 64 – WESTMOUNT HEALTH QUARTER – SITE LAYOUT



## St Helier General Hospital

The proposal for the future St Helier General Hospital is for a large new build development on the western perimeter (Overdale) and extensive sensitive refurbishment of those existing buildings suitable for continued hospital use.

FIGURE 65 – AN INDICATION OF THE MIX OF NEW BUILD AND REFURBISHMENT WORKS AT THE HOSPITAL



## Funding

A completely new hospital development on the current site would be unaffordable at circa £462m.

Therefore a £297m target project budget has been set as one that was prudent in the current economic conditions.

The new Westmount Health Quarter and St Helier General Hospital can be developed within that budget.

Funding has been identified for a radiographic department within the St Helier General Hospital meaning cancer patients can receive treatment on island.

Proposals for short term theatre and bed capacity have been funded and some social services functions at Overdale will also be re-provided within this funding envelope of £297m.

# 17. Appendix B

## Housing refurbishment and new build projects

The Housing business case refers to refurbishment and new build projects. These are listed below along with the estimated total costs from R015/2013. For comparison purposes, the projects included at Outline Business Case stage are also included. Individual project costs are not shown as this is considered to be commercially sensitive. Costs are indicative and are subject to change, particularly for projects for which feasibility studies have not yet been performed. Costs will be managed by the Housing Company as each of the projects is progressed.

## FIGURE 66 – HOUSING SCHEMES PLANNED FOR FUNDING FROM BORROWING OF £250M

| Refurbishment Costs | OBC stage £000s | FBC stage £000s |
|---|---|---|
| Repayment for Pomme D'or scheme | | |
| Le Squez - Phase 3b | | |
| Victoria Cottage Homes (new build project at OBC stage) | | |
| Jardin des Carreaux | | |
| La Collette | | |
| Journeaux Street Intensification | | |
| Hampshire Gardens Convent Court Caesarea Court | | |
| De Quetteville Court High Rise | | |
| Hue Court High Rise | | |
| Osborne Court | | |
| **Refurbishment Costs** | **42,274** | **54,257** |
| **New build costs on existing housing sites or sites covered by P40/2012** | **£000s** | **£000s** |
| Repayment for Le Squez - phase 2a and 2b | | |
| Le Squez – Phase 2c | | |
| Journeaux Street, 2–4 | | |
| Lesquenade 1 | | |
| Ann Court (project being undertaken by a Housing Trust) | | |
| Le Squez - Phase 4 | | |
| Le Squez - Phase 5, 7, 8 | | |
| Le Squez - Phase 6, 9, 10, 11 and 3a | | |
| Victoria Cottage Homes (refurbishment project at FBC stage) | | |
| Lesquenade 2 | | |
| Fields 516, 517 and 518 St Saviour | | |
| La Collette – Block B and C | | |
| La Collette – Blocks C, D and F | | |
| **New build costs** | **89,664** | **116,060** |
| **Total refurbishments and new build costs** | **131,938** | **170,317** |
| **New build costs on other social housing sites** | **£000s** | **£000s** |
| Former Le Coin Site Summerland Site Ambulance Station Site Pine Ridge | | |
| Additional new build costs | – | 31,055 |
| **Total** | **131,938** | **201,372** |
| Other | | 6,000 |
| | | 207,000 |
| Provision for re-zoned sites / Site acquisition | | 43,000 |
| Total borrowing requirement | | 250,000 |

# 18. Appendix C

FIGURE 67 – SEWERAGE NETWORK

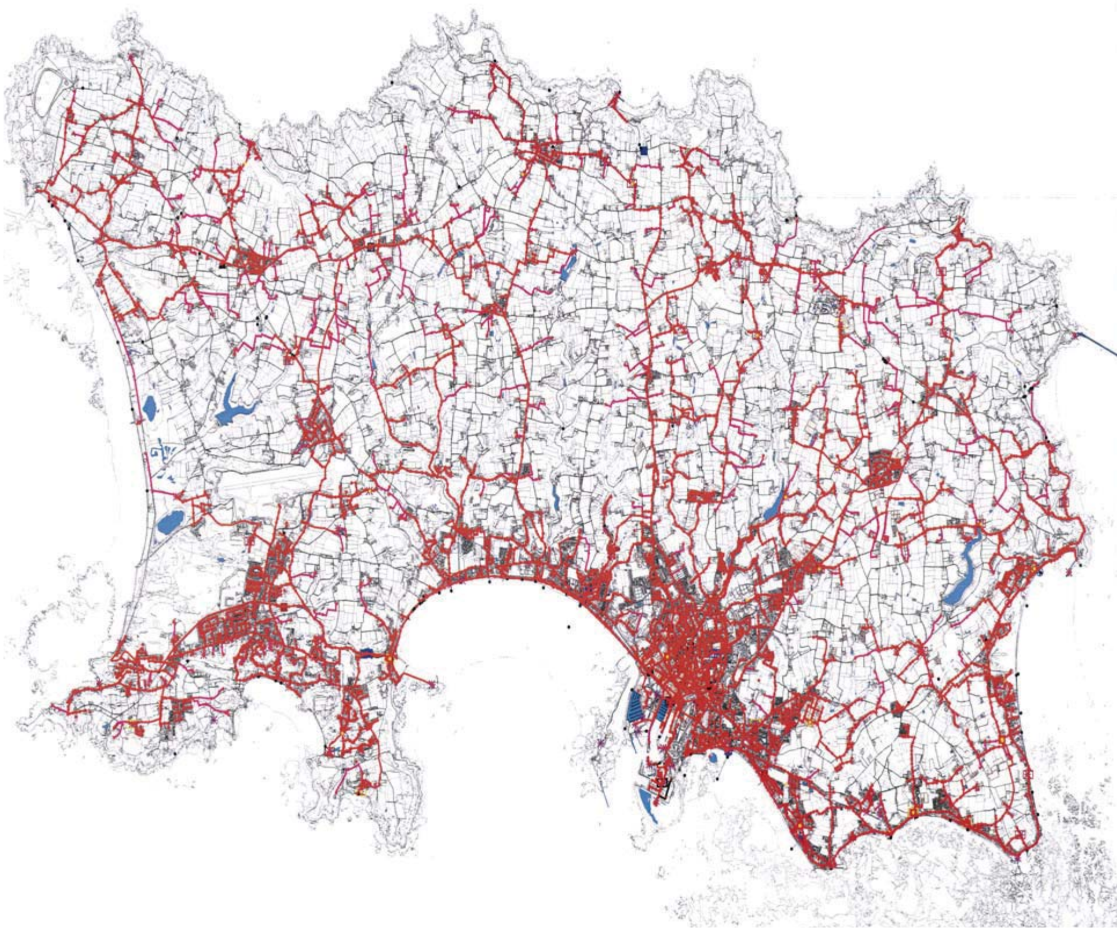
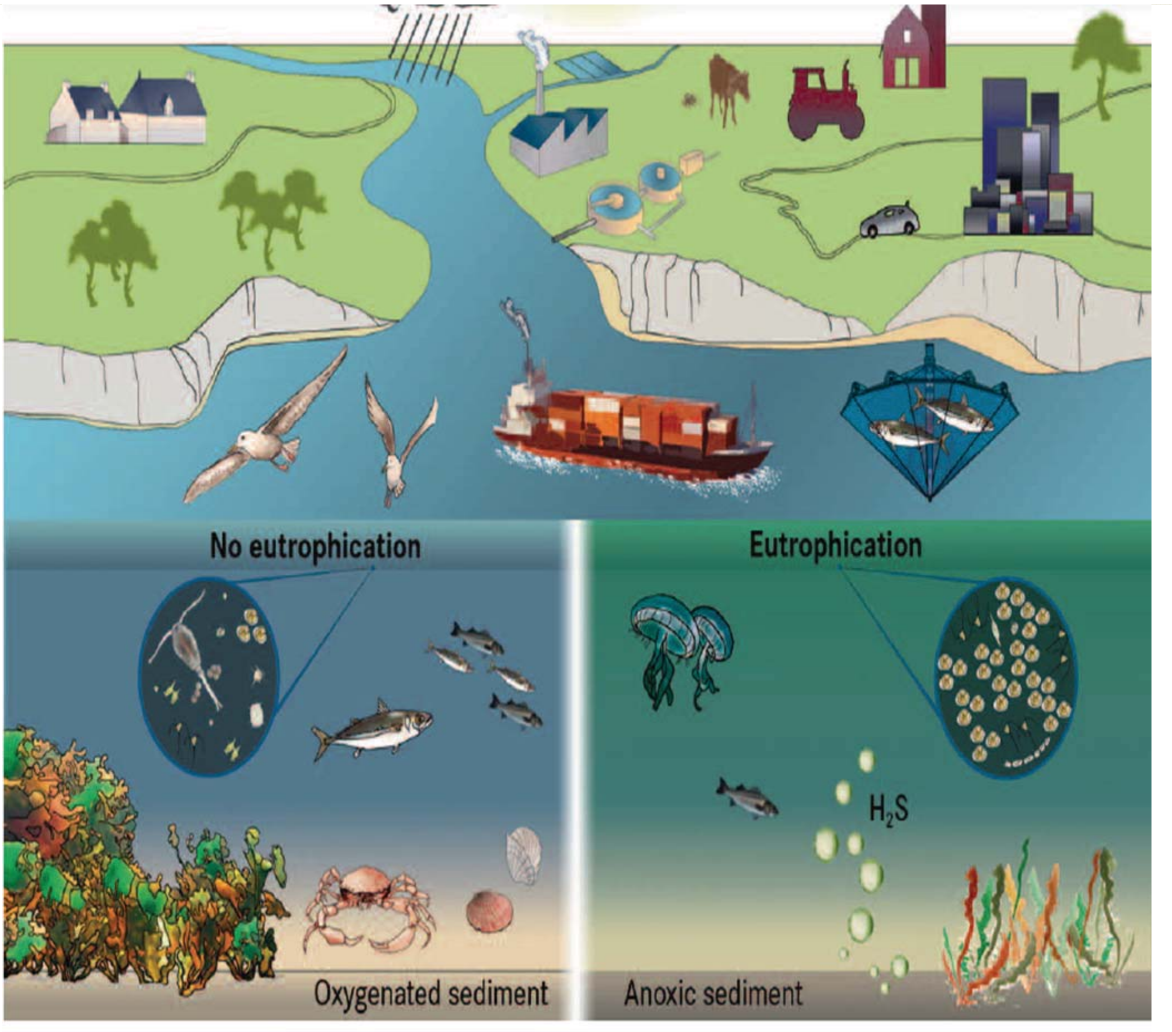


FIGURE 68 – WATER FRAMEWORK DIRECTIVE



## FIGURE 69 – AGEING SEWAGE TREATMENT WORKS

## FIGURE 70 – DRIVERS FOR CHANGE

FIGURE 71 – AGEING SEWAGE TREATMENT WORKS

## FIGURE 72 – AGEING SEWAGE TREATMENT WORKS

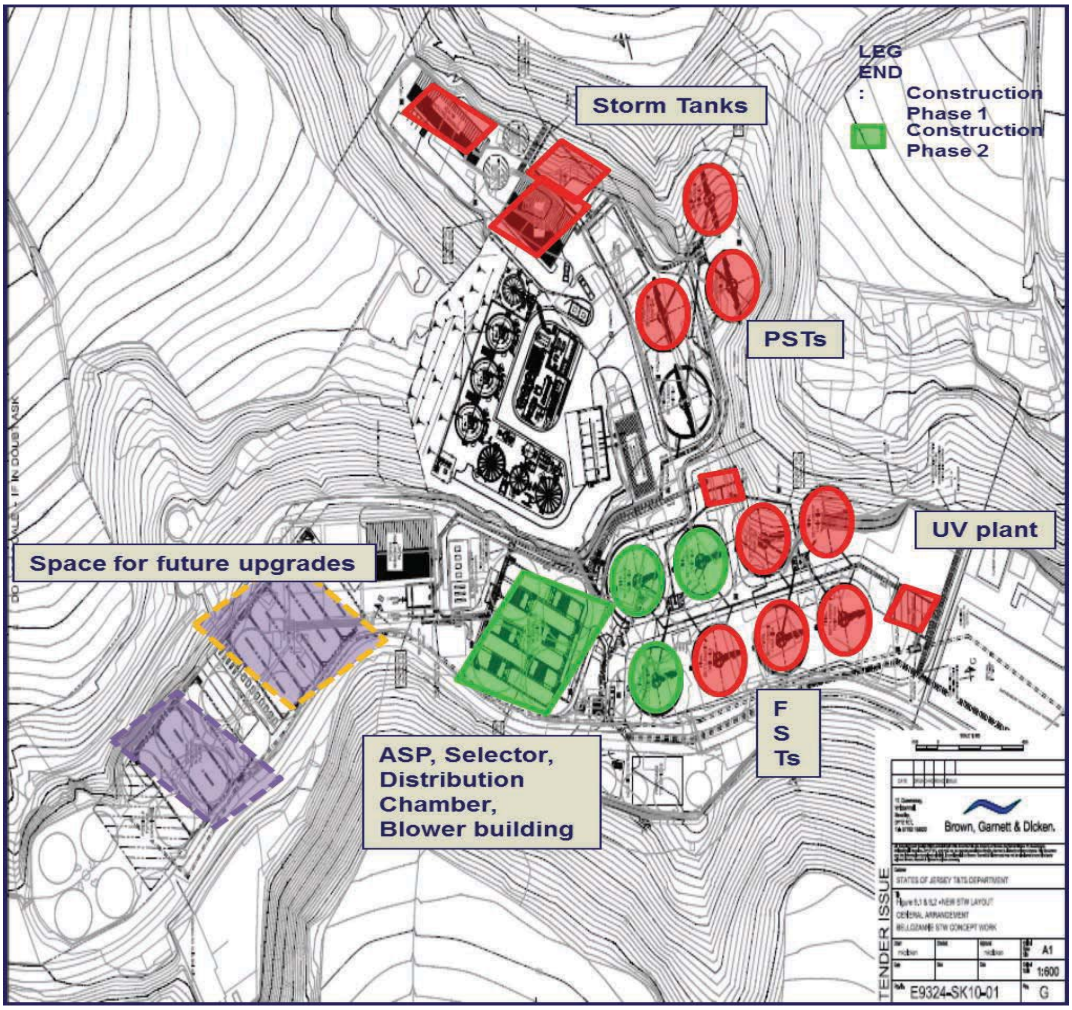
## Upgrading the Sewage Treatment Works will Allow For:

- Odour control facilities.
- Higher automation.
- Electricity generation.
- Reduced staffing.
- Additional treatment capacity at the works(over 30%).
- Additional storm sewage storage at the works.

Resulting in: No more storm sewage being discharged via the outfall into St Aubins Bay

FIGURE 73 – EXAMPLES OF NEW, EFFICIENT, LIQUID WASTE INFRASTRUCTURE

FIGURE 74 – POSSIBLE CONFIGURATION OF NEW PLANT AT BELLOZANNE




## Challenges

**Location** – Bellozanne identified as most suitable site. Network diversions to a new location are very costly

**Process** – Conventional Activated Sludge process which is adaptable for all treatment options

**Surface water reduction in foul sewers** – releases sewer capacity but not treatment plant size

# 19. Appendix D – The Steps Involved In Issuing A Public Bond

## Strategy Execution – Debt Issuance

## Appointing Advisors

There is a small range of advisors that the States of Jersey will need to appoint, in a competitive manner.

The roles for which appointments will be made at the start of the issuance process include:

- Bookrunner(s): Responsibilities are numerous, with main roles including production of investor presentation, arranging road show logistics, marketing to potential investors, bookbuilding and documentation, including the Prospectus (which is the main Offering Document to potential investors).There is unlikely to be a cost benefit to the States of Jersey in appointing bookrunners for more than one bond at a time and they are normally appointed on a deal by deal basis to ensure competitive tenders for each assignment.

- Legal advisor: Responsibilities of legal advisors include the drafting of documentation. Documents that will require legal input include:

  i. The Prospectus, which will be signed off by the appropriate Listing Authority. This is the FSA if a London listing is chosen;

  ii. Subscription Agreement, which is a relatively standard legal agreement between the States of Jersey and the bookrunners, covering the terms on which the bond will be issued and the representations and warranties of all parties;

  iii. Trust Deed, which is a legal agreement with the Trustee, setting out the limit of empowerment to act for the bondholders as a group;

  iv. Agency Agreement, which will be the agreement between the States of Jersey and the Paying Agent; and

  v. Auditors Comfort Letter, which gives the underwriting banks comfort that the Prospectus is accurate. This is usually a standard form letter.

- Legal advisors will be required for both the States of Jersey and the bookrunner(s).

- Paying Agent: Usually one of the bookrunners, who will be responsible for the disbursement of funds in connection with the bond, will act as Paying Agent. The paying agent will receive coupon payments from the States of Jersey, and pass on to the holders of the bonds.

- Trustee: Again, usually one of the bookrunners will take the role of trustee. The trustee sees that bond interest payments are made as scheduled, and protects the interests of the bondholders if the issuer defaults. The trustee is responsible for the registration, transfer and payment of bonds.
- Trustee legal advisor: Legal counsel will be required for the trustee.
- Indicative anticipated costs for the roles that require appointing are shown in section.

## Indicative Upfront Costs

There are large number of upfront fees associated with a public bond issuance, and a small number of ongoing fees

Bookrunner fees and credit rating fees on issuance have been calculated assuming a bond size in the region of £200m -£500m.

The other upfront costs, included in the table below, are likely to be in the ranges proposed irrespective of the size of the bond.

FIGURE 75 – INDICATIVE COSTS OF ISSUING A PUBLIC RATED BOND

| | Indicative estimate up front costs* | Comments |
|---|---|---|
| **Bookrunners#** | £420,000 – 1,050,000 | 18 - 21bps of the funds raised is typical, however we will look to reduce through competitive tender. Fee is paid upfront, one-off and shared across all bookrunners |
| **Credit ratings** | £110,000 – 275,000 | 5.5bps on any bond issuance (3.5bps for S&P and 2bps for Fitch) |
| **Issuers Legal Counsel** | £50,000 – 80,000 | Subject to a competitive tender. Fixed fee (i.e. not based on quantum raised), required on each bond issued |
| **Bookrunners Legal Counsel** | £50,000 – 90,000 | Subject to a competitive tender. Fixed fee, required on each bond issued |
| **Trustee and Paying Agent** | £3,000 – 5,000 | Subject to a competitive tender. Fixed fee, required on each bond issued |
| **Trustee Legal Counsel** | £10,000 – 15,000 | Subject to a competitive tender. Fixed fee, required on each bond issued |
| **Auditor's Comfort Letter** | £5,000 – 8,000 | Fixed fee, required on each bond issued |
| **Stock Exchange Listing Fee** | £5,000 – 10,000 | If the bond is listed in London, this is a one-off fee per bond. |
| **Roadshow and Printing Costs** | £5,000 - 10,000 | Dependent on scope of roadshow and travelling party. A roadshow will be required with each issuance |

*Subject to the States of Jersey's negotiations.

In addition to the upfront costs listed above, there will be a small number of fees which are ongoing for the life of the bond. These include an ongoing assessment fee to the rating agencies of around £32,000 per rating agency and the fee to the Trustee and Paying Agent. These costs can be met from within Treasury's existing resources.

Unlike some other exchanges, the London Stock Exchange does not charge annual fees for listing bonds. This makes a long term bond very cost effective. We have assumed a London listing to maximise liquidity and secondary appetite for the bonds, which ultimately maximises pricing efficiency. Comparable sovereign bonds (UK, Isle of Man) are listed on the London Stock Exchange.

## Designing an Invitation to Tender

Designing an Invitation to Tender ('ITT'), alternatively known as a Request for Proposal, and the subsequent assessment of potential bookrunner(s) will be critically important in maximising the marketing channels available to the States of Jersey

We will develop a suggested ITT document to select a bookrunner(s), which will be designed to assess key criteria of representative banks. Factors will include:

- Relevant experience: A demonstrable track record of dealing with sovereigns will be essential, as will evidence of arranging debut capital markets issuances. Ideally your bookrunner(s) would have experience of arranging the debut issuance of a sovereign, although we would not recommend that this be a limiting criteria.

- Size, locations and capability of sales and distribution force: The States of Jersey should target bookrunner(s) that have the ability to reach as wide a potential investor base as possible. This allows the States of Jersey to maximise the order book, create competitive tension amongst investors and increase pressure on the pricing.

- Market research and marketing approach: The bookrunner(s) will need to demonstrate an understanding of the States of Jersey's objectives to be able to best market the issuance. For instance, understanding that oversubscription should lead to increasingly selective acceptance of offers, rather than an increase in the quantum of the bond. The bookrunner(s) should also understand the States of Jersey's desire to maximise offers received rather than selectively managing the investor base ahead of any subsequent issuance.

- Sales strategy, including highlighting who they believe to be key investors: Our view is that, with a well-considered marketing strategy, the States of Jersey's debut issuance is likely to attract significant interest across the investor universe. During the bookbuilding phase, the bookrunner(s) should maintain a dialogue with any investors that the States of Jersey is keen to include, (for example any Jersey based investors to allow for local investment in the States of Jersey) to ensure that any bids received from local investors are such that they are likely to result in allocation. A view on the pros and cons of a States of Jersey fund as an anchor investor will also be sought.

- Views on current market and planned timing of the deal: The conditions of the capital markets and potential timing of issuance will be crucial to ensuring a best deal for the States of Jersey. The ITT will ensure bookrunner(s) present a view and outlook of the credit markets and best timing for the States of Jersey.

- Unique ability to add value to the deal: Any specific unique capabilities of the bookrunner(s) to meet the aims of the States of Jersey. These abilities will be highlighted by the banks as part of their responses to the ITT, with the onus on the banks to present experience or insights which distinguishes them from their competitors.

- Performance in relevant league tables: Comparison and track record against peers to ensure established and experienced bookrunner(s) are appointed.

- Due diligence: The bookrunner(s) would need to comply with the States of Jersey's due diligence process, i.e. providing suitable references, credit checks, contracts etc as detailed in the ITT.

- Fees: Acting as bookrunner to the States of Jersey's debut bond issuance will be a highly prestigious role for bookrunner(s). The fee quote should reflect best value for the States of Jersey.

## Bookrunner Roles

To obtain best value for the States of Jersey, we would advise that the number of bookrunners is kept low.

- There is not a linear relationship between funds raised and the number of bookrunners. It is usual to have more than one bookrunner, but usual to keep the group small to ensure appropriate focus.

- The dynamic between issuers and relationship banks tends to have a bearing on how roles and responsibilities are allocated on a bond issue. As the States of Jersey does not have any significant borrowings, this dynamic will not be significant therefore we would advise appointing a small, focused group of banks.

- A robust tender process will identify the banks with the strongest capability in relation to the States of Jersey's requirements. A £400-500m Sterling bond issue for a high investment grade credit rating will be well within the core competency of many investment banks and therefore there is no requirement to appoint a large group of banks in order to ensure adequate take up or a liquid market in the securities.

## FIGURE 76 – STERLING BOND BOOKRUNNER LEAGUE TABLE (BY AMOUNT, JAN 2012 TO FEB 2013)

| Rank | Bookrunner | Amount (£bn) | Number of issues |
|---|---|---|---|
| 1 | Barclays | 19.1 | 120 |
| 2 | HSBC | 17.9 | 118 |
| 3 | Deutsche Bank | 17.0 | 100 |
| 4 | RBS | 16.2 | 125 |
| 5 | Lloyds TSB Corporate Markets | 10.8 | 72 |
| 6 | RBC Capital Markets | 10.0 | 84 |
| 7 | UBS | 8.5 | 49 |
| 8 | Goldman Sachs | 6.6 | 33 |
| 9 | Credit Suisse | 6.1 | 34 |
| 10 | Banco Santander | 5.9 | 34 |
| 11 | BNP Paribas | 5.1 | 37 |
| 12 | Morgan Stanley | 4.7 | 15 |
| 13 | Nomura | 4.0 | 14 |
| 14 | JP Morgan | 3.9 | 27 |
| 15 | Bank of America Merrill Lynch | 3.8 | 25 |
| 16 | Citi | 3.1 | 19 |
| 17 | Société Générale | 1.4 | 8 |
| 18 | Credit Agricole | 1.3 | 5 |
| 19 | Deutsch Pfandbriefbank | 1.1 | 2 |
| 20 | National Australia Bank | 0.6 | 6 |

It is common market practice in the investment grade Sterling market for two bookrunners to be appointed. The main responsibilities of the bookrunners will be documentation and investors presentations / road show organisation – splitting of these roles and responsibilities should occur as follows:

- A bank should be mandated as Lead Bank in relation to documentation -it will be their role to coordinate information flow and document production.
- The bank that demonstrates the best understanding and articulation of the credit should lead the investor presentation.
- The bank that can demonstrate recent and repeat experience in marketing Sterling bonds should lead the roadshow logistics.
- A bank should be allocated the task of leading the bookbuilding process, this bank should have the appropriate systems and experience.
- The league table above indicates the prominent bookrunning banks in the Sterling public bond market from January 2012 to date (February 2013).

## Leading Bookrunners

The following tables highlight the bookrunners on some of the most recent Sterling and Sovereign bond issuance as at 14 February 2013.

### FIGURE 77 – EXAMPLES OF INSTITUTIONS AND SOVEREIGNS ISSUING STERLING BONDS

| Date | Issuer | Amount (£m) | Bookrunner |
|---|---|---|---|
| Feb-13 | Network Rail | 600 | DB, RBC |
| Feb-13 | Nordea Bank | 400 | HSBC, UBS |
| Feb-13 | High Speed Rail | 760 | BNP, LBG, NAB, RBS, Scotia |
| Jan-13 | European Investment Bank | 500 | BAR, DB, HSBC, JPM, RBC |
| Jan-13 | Network Rail | 750 | DB, HSBC, RBS |
| Jan-13 | Severn Trent Utilities | 500 | BNP, HSBC, RBS, SANT |
| Dec-12 | Notting Hill Housing Trust | 250 | Barcap, GS, LBG |
| Dec-12 | GlaxoSmithKline | 1,400 | DB, GS, HSBC, RBS |
| Dec-12 | WM Treasury | 200 | BAR, RBS |
| Nov-12 | Nestle | 400 | SANT, BAR, BNP, Citi, CS, DB, GS, HSBC, JPM, BASML, MIS, RBS, SG, UBS |
| Nov-12 | Intercontinental Hotels | 400 | HSBC, LBG, RBS |
| Nov-12 | APT Pipelines | 350 | BNP, RBS |
| Nov-12 | Transport for London | 300 | BAR, HSBC, MS |
| Nov-12 | Nordic Investment Bank | 250 | HSBC, RBC |
| Nov-12 | Pohjola Bank | 250 | LBG |
| Nov-12 | Swed Bank | 250 | NOM, RBS |
| Nov-12 | London Stock Exchange | 300 | BAR, LBG, RBS |
| Oct-12 | Export Development Canada | 300 | HSBC, RBC |

| Date | Issuer | Amount (US$m) | Bookrunner |
|---|---|---|---|
| Feb-13 | Hungary | 3,250 | BNP, Citi, DB, GS |
| Feb-13 | Ukraine | 1,000 | JPM, VTB Capital |
| Jan-13 | United Kingdom | 6,303 | HSBC, JPM, MS, RBC |
| Jan-13 | Lithuania | 538 | Barcap, Citi |
| Jan-13 | Israel | 2,000 | BAR, Citi, GS |
| Jan-13 | Sweden | 5,386 | Danske, GS, JPM, RBS |
| Jan-13 | Republic of Portugal | 3,329 | Barcap, Banco Espirito, DB, MS |
| Jan-13 | Colombia | 1,000 | DB, GS |
| Jan-13 | Kingdom of Spain | 9,328 | Barcap, BBVA, Citi, GS, SANT, SG |
| Jan-13 | Republic of Italy | 7,979 | Banca IMI, Barcap, CA, GS, JPM |
| Jan-13 | Slovak Republic | 1,959 | HSBC |
| Jan-13 | Kingdom of Belgium | 5,223 | Barcap, Citi, RBS, SG |
| Jan-13 | Poland | 1,308 | BNP, DB, HSBC, UniCredit |
| Jan-13 | Ireland | 3,270 | Barcap, Danske, Davy, RBS, SG |
| Jan-13 | Republic of Turkey | 1,500 | BNP, DB, GS |
| Jan-13 | Mexico | 1,500 | BAR, JPM |
| Dec-12 | Republic of Lativa | 1,250 | BAR, DB, JPM, |
| Dec-12 | Kingdom of Morocco | 1,500 | BAR, BNP, Citi, NAT |
| Dec-12 | Republic of Turkey | 1,000 | BASML, HSBC, RBS |
| Nov-12 | Mongolia | 1,500 | BASML, DB, HSBC, JPM, T&D Bank of Mongolia |

## Key

| | | | |
|---|---|---|---|
| Bank of America Merrill Lynch | BASML | ING Groep | ING |
| Banco Santander | SANT | JP Morgan | JPM |
| Barclays Bank | BAR | Lloyds Banking Group | LBG |
| Barclays Capital | Barcap | Mitsubishi | MIS |
| BNP Paribas | BNP | Morgan Stanley | MS |
| Commerzbank AG | CZB | Natixis | NAT |
| Crédit Agricole | CA | National Australia Bank | NAB |
| Credit Suisse | CS | RBC Capital Markets | RBC |
| Deutsche Bank | DB | RBS | RBS |
| Goldman Sachs | GS | Société Générale | SG |
| HSBC | HSBC | UBS | UBS |

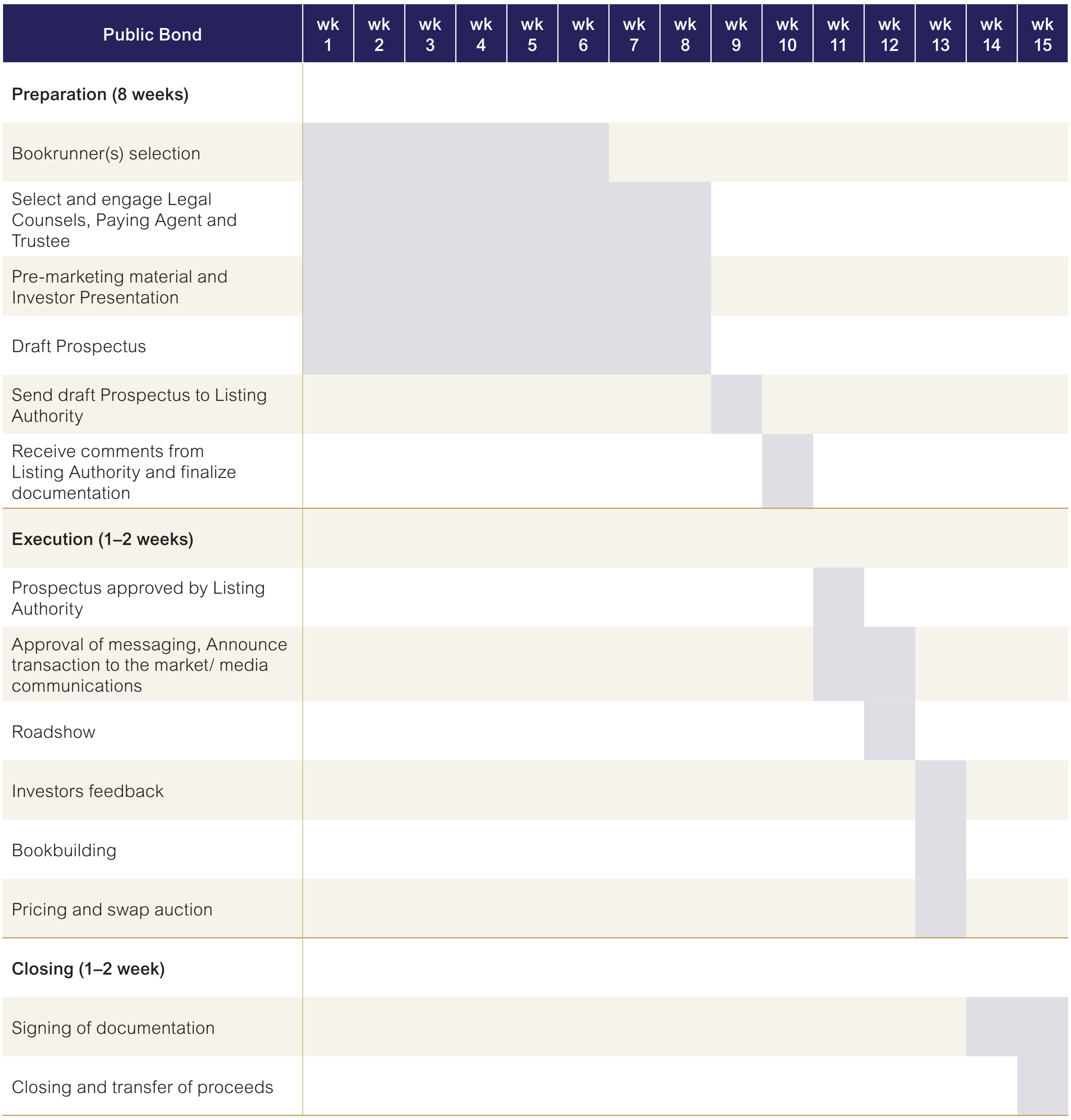
Source: Bloomberg, ThomsonOne

## Timeline for Execution

Execution of a Sterling public bond can be achieved in as little as 12 weeks, once the credit rating has been assigned.

The Chart below sets out the typical profile of a bond issuance.

### FIGURE 78 – A TYPICAL TIMETABLE FOR BOND ISSUANCE



## Prospectus Preparation

The Prospectus is the main marketing document for the bond. The Prospectus will need to educate potential investors in great detail about the commercial and financial position of the States of Jersey.

- The Prospectus is a key document as it gives the issuer the opportunity to explain why the instrument is an attractive investment.

- A Preliminary Prospectus will have all the information about the issuer and the bonds being offered, except for the pricing information. The Final Prospectus will include the pricing information and will be delivered to investors along with a trade confirmation by the underwriter to confirm sales of the bonds.

- The required contents of the Prospectus are described below.

### FIGURE 79 – OUTLINE OF A BOND PROSPECTUS FOR JERSEY

| Business description | Other information |
|---|---|
| • A brief overview and history of the States of Jersey | • Overview of the bonds |
| • Description of the States of Jersey's structure, and operating activities | • Financial statements and auditor's report (last two years) |
| • Description of the economic profile of the States of Jersey | • Use of funds |
| • Detailed understanding of the relationship with the UK and Bank of England | • Terms and conditions of the bonds |
| • A section on risk factors related to the States of Jersey, the home country political and economic environment and the issuance of bonds along with mitigants to provide comfort over these risks | • Details of lead banks |
| • A section on the regulatory environment and any material litigation | • Details of anticipated rating of the notes |
| • A description of senior management / ministers | • Taxation considerations |
| • A description of governance processes | |

## Roadshow

The prospectus is the main marketing document. Following the completion of the prospectus, it would be necessary to market the bond through a roadshow, focusing on UK investors.

- A roadshow of UK investors can typically be conducted in 2-3 days and focuses on investors based in London and Scotland. A leg of the roadshow could be conducted in Jersey with specifically identified and invited investors. Investor meetings will provide the States of Jersey with an opportunity to present its credit proposition, the specifics of the deal, and respond to any questions that investors have.

- Investors will appreciate the opportunity to meet the States of Jersey's representatives, understand first hand the credit proposition and offering and ask questions.

- In addition to a series of one-on-one meetings, a global Investor call is recommended by Ernst & Young, allowing any non-UK investors to hear the prepared presentation of the bond from the States of Jersey first hand, with the opportunity to ask questions.

- Summarised below a number of the top investors in the Sterling bond market. The vast majority of these investors also have a track record of investing in 10 year sovereign public bonds.

FIGURE 80 – THE TOP INVESTORS IN THE STERLING BOND MARKET


A roadshow meeting will generally focus on a presentation of 30 minutes or so followed by questions.

The States of Jersey would likely conduct five or six bilateral meetings each day of the roadshow presenting the credit proposition and answering due diligence questions from potential investors in a 30-60 minute meeting, plus a group presentation and conference call with investors that are not able to meet the States of Jersey.

The bookrunner(s) will arrange and coordinate the logistics and participants of the roadshow. The bonds could be offered to local investors by timetabling an additional half day into the roadshow and could use local stockbrokers in combination with the bookrunning banks, however this would be at the discretion of the banks who will lead the sales and marketing of the bonds.

FIGURE 81 – STERLING ROADSHOW TIMETABLE

| | | |
|---|---|---|
| **Day 1** | London | One-on one meetings<br>Group presentation |
| **Day 2** | | One-on-one meetings<br>Global investor Call |
| **Day 3** | Glasgow / Edinburgh | One-on-one meetings |
| **Day 4** | Jersey | Optional local one-on-one meeting |

# Bookbuilding

**Bookbuilding is a short exercise, but is critical to the success of the issuance**

Bookbuilding is the collection of bids for a certain quantum at a specified price. It is confidential to the bookrunner(s) and the States of Jersey.

The bookrunner(s) will advise the States of Jersey through a constant flow of market commentary, including advice on timing the bookbuilding so as to avoid conflict with a competing deal that may detract from the States of Jersey's issuance. Advice will also involve continued guidance and communication with potential investors of indicative pricing levels.

Once the book has been closed and all bids have been collected, the bookrunner(s) and States of Jersey can evaluate the demand levels and offers received and decide upon a profile of investor base and price level.

Bookbuilding will be best facilitated by bookrunner(s) that have the best relationship with the universe of Sterling investors, and will be able to leverage relationships to reduce the new issuance premium and drive the price down. We anticipate that the States of Jersey's bond will be extremely sought after and that the order book will be oversubscribed against the target issue amount.

- An oversubscribed book usually provides two possibilities:
- The issuance size is upscaled to take advantage of current offers

Competitive tension amongst investors drives improved terms for the issuer.

As the States of Jersey does not intend, and is in fact unable due to the borrowing cap, to increase its issuance size, we anticipate that it will be able to be selective about from which investors to accept offers and the terms of the final bond.

The States of Jersey may wish to allocate a small quantum of bonds to a diverse range of investors, or it may prefer its bond to be held by a small group of the largest institutional investors. All investors that receive allocations in the bond must have bid at or below the clearing price, which will have been guided by the bookrunners and the States of Jersey. If the States of Jersey wishes a specific investors to partake in the bond (for example, allowing for investment on-island), the bookrunner will manage the communication with that investor to ensure that its bid is below the anticipated clearing price.

The bookrunners, will keep the States of Jersey fully appraised of latest market data and pricing points, allowing live information to inform final terms.

At the end of the bookbuilding process, the bookrunner(s) and the States of Jersey will work out an allocation schedule, with all bidders below the clearing price eligible for an allocation of the bonds.

# 20. Appendix E – Ongoing Debt management Strategy Post Funding

## Financial Reporting and Governance

### Ongoing reporting requirements for a public Sterling bond are not onerous

There are a number of stakeholders who will seek to monitor the credit profile of the States of Jersey including ratings agencies and bond holders.

There is no ongoing requirement to meet or engage with bondholders.

- Bondholders may contact and request to meet the States of Jersey on an ad hoc basis. It would be good practice to engage with major bondholders, especially if a future issuance is being considered.

- Should the States of Jersey chose to meet with investors, it can arrange to meet with them directly.

Following the issuance of a public bond, the States of Jersey would be required to comply with the rules and regulations of the exchange(s) on which the bond is listed.

Ratings agencies would meet with the States of Jersey on an annual basis.

Assuming typical high investment grade Sterling bond terms, no financial covenants would exist. Therefore there would be no obligation to calculate financial covenants and report compliance with these.

The States of Jersey would be required to release annual accounts to the market and these must be published within six months of the end of the period to which they relate. It would be the States of Jersey's responsibility to ensure that the annual accounts and all other information that needs to be submitted to the exchange and ratings agencies are submitted in a timely manner.

Governance processes therefore need to be in place to ensure that accounts are filed on time and interaction with stakeholders occurs when necessary.

## Covenant Considerations

**Sterling public bonds include a number of common covenants however financial covenants for high investment grade issuers (i.e. Issuers within the AAA and AA rating bands) are not common**

Sterling bond documentation typically includes a number of standard clauses to protect investors against a material deterioration in the credit quality of the issuer and to protect the position of investors in the capital structure.

As the States of Jersey does not have an existing bank facility or has not had any external debt in the recent past, there is no precedent for a suite of covenants that it has offered to previous lenders.

There is a fine balance between offering suitable covenants to gain sufficient interest in the deal and reducing flexibility for the issuer. The level of comfort investors gain from the covenants offered will be reflected in the pricing achieved.

Ernst & Young would not expect investors to require financial covenants.

Common non financial covenants in Sterling bond documentation include negative pledge, pari passu and cross default clauses.

- Negative pledge clause – stops the issuer pledging specific security to another party. Should the States of Jersey raise any additional debt subsequent to the proposed issuance, this covenant would prohibit it from assigning the new debt providers with specific security.

- Pari passu – ensures that the debt does and will rank alongside any other senior debt in terms of priority rankings. As the States of Jersey currently does not have any debt, this covenant would not be relevant to bond holders. However, should the States of Jersey raise additional debt subsequent to the potential bond issuance, this covenant would not allow the new debt providers to rank senior to the bond holders. The covenant protects the investor's security position.

- Cross default clause – if the issuer has more than one external debt agreement, a cross default clause says that if, for any reason, a default is recorded under one of the agreements, the other debt agreement(s) shall also register as being in default.

All of the covenants have minimal impact on the States of Jersey's profile as of today, but provide investors with comfort that they will retain at least equal rights to any lenders / investors in future external debt agreements.

Covenants are typically set according to precedents e.g. Isle of Man, and more recently, Cambridge University. Negative pledge, pari passu and cross default clauses were included in the Cambridge bond, we would not expect any further covenants for the States of Jersey.

# Maintaining a Credit Rating

**A credit rating is an ongoing obligation that the States of Jersey must maintain whilst public bonds are outstanding**

Credit rating agencies are important stakeholders. Continued communication and provision of information is key to ensure that they are fully informed with developments.

Assigned credit ratings will be reviewed by the agencies on an ongoing basis. Any material changes in the credit quality of the issuer will be reflect in the assigned rating, therefore ratings upgrades and downgrades are a common occurrence.

The ratings agencies tend to take the approach of rating 'through the cycle', meaning that they aim to ensure that the rating reflects medium and long term trends rather than short term fluctuations.

Credit market investors, particularly bond investors, place a high level of reliance on the views of the ratings agencies therefore any ratings changes are likely to be reflected in the actions of investors trading the bonds in the secondary market.

- For instance, a downgrade of a rating will likely translate into the price of a bond falling in the secondary market and its yield correspondingly rising. Whilst this does not affect the interest paid by the issue (by virtue of the bond coupon being fixed), it would directly impact the cost of any subsequent issuance as investors will view the risk profile differently and expect to be rewarded accordingly.

Due to a vast number of high profile downgrades since the onset of the financial crisis, the media and general public are much more aware of the significance of credit ratings and therefore ratings changes are a larger driver of public perceptions than was historically the case.

The States of Jersey will be obliged to inform the agencies of any material developments and issues that arise and are potentially likely to affect its credit profile/quality. The States of Jersey are not obliged to provide investors of a public bond with this information. The agencies would provide guidance on the types of issues they would require the States of Jersey to report and provide information on. The agencies would also provide guidance on the rating rules and guidelines that the States of Jersey would be required to follow.

As part of the initial credit rating process, a lead analyst would be appointed to review and assess the States of Jersey credit profile. The lead analyst would be the key contact on the States of Jersey's credit rating within the agency.

Each year there will are a number of activities that need to be undertaken, these include:

- Present to each agency separately. The presentation should cover an update of the information provided in the initial rating submission. Any non-financial topics that have not been subject to change do not need to be covered in detail, however an update on financial information will be required each year.

- Payment of an annual fee (typically the same as the initial assessment fee).

# 21. Appendix F

## Note on Limitations to Borrowing

Jersey Law limits the level of external debt that the States of Jersey can raise.

Paragraph 3 of Article 21 of the 'Public Finances (Jersey) Law 2005', Borrowing by the States of Jersey, states that "The States shall not authorize any borrowing if it would permit the total amount borrowed by the States at that time to exceed an amount equal to the estimated income of the States derived from taxation during the previous financial year." Paragraph 4 of Article 21 goes on to state that "in calculating the total amount borrowed by the States for the purpose of paragraph (3) there shall not be taken into account –

(a) any amount borrowed from a third party by a company owned or controlled by the States; and

(b) the liability of a company owned or controlled by the States under any guarantee or indemnity given by the company."

Regulation 9 (7) of Chapter 3 of the Public Finances (Transitional Provisions) (No.2) Regulations 2005, states that "for the purpose of this Regulation,

- borrowing by the States shall be taken to include the giving of a guarantee in the name of the States and the provision of an indemnity in the name of the States; and

- the liability of the States in respect of any such guarantee or indemnity shall be taken as an amount borrowed by the States."

Based on The Public Finances (Jersey) Law 2005 and The Public Finances (Transitional Provisions) (No.2) Regulations 2005, the annual borrowing cap of the States of Jersey is dictated by the revenue generated through taxation in the previous year less current borrowings of the States of Jersey as highlighted in the table.

It is assumed in this report that the cap on external debt is calculated based upon 2012 as this is the most recent cap based on outturn full year financial results.

## FIGURE 82 – CALCULATION OF THE MAXIMUM BORROWING REQUIREMENTS FOR THE STATES OF JERSEY UNDER THE PUBLIC FINANCE LAW

| £m | 2011[1] | 2012[2] | 2013[2] | 2014[2] | 2015[2] | 2016 |
|---|---|---|---|---|---|---|
| **Income tax** | 409.3 | 430.0 | 450.0 | 470.0 | 500.0 | - |
| **Budget measure** | - | - | 7.6 | 7.6 | 7.6 | - |
| **Goods and Service Tax** | 66.3 | 77.7 | 79.8 | 82.0 | 84.5 | - |
| **Imports Duty** | 51.1 | 51.1 | 52.9 | 53.0 | 53.1 | - |
| **Stamp Duty** | 22.6 | 22.9 | 24.5 | 27.7 | 29.0 | - |
| **Total taxes** | 549.3 | 581.7 | 614.8 | 640.3 | 674.2 | - |
| **Less Guarantees[3]** | 20.8 | 20.8 | 20.8 | 20.8 | 20.8 | |
| **Net amount** | 528.5 | 560.9 | 594.0 | 619.5 | 653.4 | - |
| **Annual borrowing cap** | - | 528.5 | 560.9 | 594.0 | 619.5 | 653.4 |

Sources: States of Jersey Financial Report and Accounts 2011; Medium Term Financial Plan.

(1) These numbers are based on 2011 Actual tax receipts, page 16 of the Financial Report and Accounts for 2011.

(2) These numbers are based on 2012-2015 forecast tax receipts as reported in the draft Medium Term Financial Plan (MTFP) (Project P.69/2012) – page 18.

(3) Note: These guarantees are not recognised on the States of Jersey's balance sheet but are required to be included in the calculation. As at 31.12.11 they were made up of £14.9m to JNWWC, £3.8m Jersey Arts Trust, £1.7m for Student Loan Guarantees and £0.4m for Small Firms Loan Guarantee Scheme. It is expected that they will continue at these levels or decrease slightly.

# 22. Appendix G – Borrowing through a Public Rated Bond: Credit Ratings

## Credit Rated Peers

If the States are to issue a public rated bond, then the States needs to take a credit rating.

The broad peer group for the States of Jersey consists of smaller, relatively wealthy sovereign states, with a high proportion of national income derived from the financial services sector, such as Lichtenstein, Bermuda, Singapore and Hong Kong. Treasury has taken Jersey's peers as being of a rating profile of AA- or better.

Jersey compares favourably to its peers with regard in Government debt based metrics, as the States currently has no external debt. However, using GVA as a proxy for GDP, the States GDP metrics compare less well, as, per the GVA report for 2011, Jersey real GVA reduced in the year.

### FIGURE 83 – CREDIT RATED PEERS: A COMPARISON WITH JERSEY

| | Guernsey* | Isle of Man | Bermuda | Hong Kong | Liechtenstein | Singapore | Jersey |
|---|---|---|---|---|---|---|---|
| **Moody's** | Not Rated | Aaa | Aa2 | Aa1 | Aaa | Aaa | - |
| **Standard & Poor's** | AA+ | AA+ | AA- | AAA | AAA | AAA | - |
| **Fitch** | Not Rated | Not Rated | AA | AAA | Not Rated | AAA | - |
| **GDP per capita (US$)** | 49,610 | 70,151 | 89,314 | 34,457 | 141,301 | 50,127 | 59,385 |
| **Real GDP (% change, annual)** | 0.7% | 2.1% | NA | 5.0% | 2.3% | 4.9% | (0.8)% |
| **Real GDP per capita (% change, annual)** | 0.4% | 2.1% | (3.1)% | 4.3% | 1.7% | 2.7% | (1.7)% |
| **General government balance (% of GDP)** | (1.0)% | (1.4)% | NA | 4.0% | (1.5)% | 8.1% | 0.0% |
| **General government debt (% of GDP)** | 0.0% | 13.4% | 2.6% | 0.6% | 0.0% | 108.3% | 0.0% |
| **Net general government debt (% of GDP)** | (105.4)% | (50.0)% | (9.8)% | (34.7)% | (96.7)% | (91.6)% | (1.8)% |
| **General government interest exp. (% of revenues)** | 0.0% | 2.0% | 6.9% | 0.1% | 0.0% | 0.0% | 0.0% |
| **Consumer price index (average; % change, annual)** | 3.1% | 6.2% | 2.6% | 5.3% | 1.0% | 5.3% | 4.5% |

*NB Guernsey withdrew its rating at the end of January 2013

## Potential Downsides of Obtaining a Credit Rating

There are considerations in obtaining a credit rating, such as the impact, financial and political, of potential changes to the ratings

Obtaining a public rating has clear reputational risks, in that a downgrade can occur for reasons completely exogenous to the States of Jersey (for example, a change in rating methodology applied by an agency).

Many stakeholders, and the general public, may not have the time or knowledge to understand the nuances of any adverse changes to a credit rating, even where it is not the 'fault' of the issuer.

Possessing and maintaining a strong relationship with rating agencies is an important part of mitigating downside risks.

The close link to the UK means that factors beyond the States of Jersey's control may affect its ratings profile.

The States of Jersey would be rated on a standalone basis, but the relationship with the UK being Jersey's single largest trading partner, with a shared currency and that Jersey is a British Crown Dependency – indicates that the perception of Jersey's credit profile will likely be affected by the position of the UK.

Whilst Jersey's rating should not be capped by the UK rating under any agency, a UK rating downgrade would create negative rating pressure on the States of Jersey's rating.

- Moody's was the first rating agency to downgrade the outlook of the UK to negative, doing so in February 2012. When Moody's downgraded the outlook of the UK to negative, it also declared that it will be re-examining the UK's rating in the first few months of 2013. On Friday, 22 February 2013, Moody's downgraded the UK's credit rating from Aaa to Aa1 with a stable outlook.

- S&P maintains the UK at a rating of AAA with a stable outlook. This rating and outlook was most recently reaffirmed in July 2012. Outlooks are designed to reflect a 3 to 5 year time horizon for rating action. Whilst we believe S&P is very unlikely to assign Jersey an 'AAA' rating, Ernst & Young advise that a prospective AA+ Jersey rating is most stable under S&P.

- Fitch, like Moody's, rate the UK at AAA with a negative outlook. The probability of an imminent Fitch downgrade of the UK is lower than that for Moody's. Fitch state the probability is 50/50 of a downgrade sometime over the next two years. The UK sovereign outlook for Fitch is therefore less likely to disrupt the Jersey rating profile than Moody's, but more so than S&P.

Maintaining two credit ratings is beneficial for two reasons. First, where the ratings are equivalent it strengthens investor confidence in the stability of the rating. Second, in the event only one of the ratings is downgraded, it can limit the impact on the price of outstanding bonds, and it eases the challenge of communication to non-financial stakeholders. There is, however, a cost associated with two ratings, namely the annual monitoring fee, as well as the additional time spent dealing with a second analytical team.

# Overview of Credit Ratings

Ernst & Young's assessment of ratings agencies suggests that obtaining ratings assessments from S&P and Fitch would be an appropriate strategy

The table below summarises Ernst & Young's assessment of the ratings agencies.

FIGURE 84 – ERNST & YOUNG'S ASSESSMENT OF RATING AGENCIES

| Factor | Comment |
|---|---|
| **Number of ratings** | There is precedent for sovereign issuers accessing the market with one rating, however two is more common. |
| **Experience of agency teams** | S&P and Fitch appeared to be offering a team that would provide a greater level of senior involvement. |
| **Timing** | Fitch committed to the shortest turnaround time (4-6 weeks), however S&P and Moody's only differed by a couple of weeks (6-8 week and 7-8 weeks indicated respectively). |
| **Cost** | Whilst Moody's proposed the lowest price, this was viewed in light of the potential ratings outcome. |
| **Information requirements** | Fitch and S&P appeared to be the most willing to work flexibly with the data available. |
| **Ratings outcome** | Whilst we would currently expect all agencies to arrive at the same outcome (AA+ equivalent), we would have expected the Moody's rating to be the least stable due to lack of clarity in the rating methodologies and potential imminent downgrade of the Isle of Man, a close peer of the States of Jersey. |

# Overview Of Risks And Mitigations For Public Rated Bond Issuance

Ernst & Young advise that there are a number risks relating to the finance raising that need to be identified and to the extent possible, mitigated

## FIGURE 85 – OVERVIEW OF RISKS AND MITIGATIONS FOR BOND ISSUANCE

| Risk | Description | Potential mitigation |
|---|---|---|
| **Execution risk** | • Due to the fact that capital markets transactions are priced with respect to market rates. There is the risk that an adverse outcome occurs if the deal is priced at the wrong point in time when the market is unreceptive and sufficient demand does not exist. | • Appointment of bookrunner who can demonstrate deep expertise in the Sterling public bond market. Suitable bookrunners will also be able to clearly articulate specific strategies they intend to deploy in order to achieve the best value pricing. |
| **Subscription risk** | • The risk that not enough investors subscribe to the debt offering – in an underwritten deal this risk is mitigated to an extent however would still likely result in adverse view of the securities. | • Appointment of bookrunner who can demonstrate a well defined marketing and sales plan, have depth of resource in sales, and who can demonstrate an insight into likely investors and their specific preferences and requirements. |
| **Stakeholder risk** | • The ultimate stakeholders are the residents of the island who are represented by the States of Jersey. | • A comprehensive approval process that ensures due process is followed. |
| **Media risk** | • The link to the political landscape ensures that sovereign issuances are subject to a high level of media scrutiny and therefore any success or failure may be amplified through press reports. | • Media communications strategy to be developed, actions and decisions documented to ensure potential future media criticism can be coherently and robustly addressed. |
| **Rating downgrade risk** | • Obtain a public credit rating and subsequently experience a downgrade. | • Maintaining a strong relationship and clear dialogue with the ratings agencies such that the States of Jersey can present the context of any potential issues or queries of the agencies. |
| **Cash flow variance** | • Risk that the States of Jersey is unable to make interest payments or contributions to any bond repayment fund that is set up or risk that Project costs are more than funds raised. | • Prudent to be applied when concluding on the level of debt that the State of Jersey can afford to service. Modelling of stressed scenarios, contingency plans to enact in the event that debt servicing becomes more challenging. Ensure debt raised when certainty over Project costs. |
| **Regulatory and legal risk** | • The risk that the debt raising and marketing, and ongoing obligations relating to the issuance do not abide by relevant laws, regulations and legal documents. For example, the issuance proceeds must be such that they do not cause the States of Jersey to breach the borrowing cap set out in the Public Finances (Jersey) Law 2005. | • Appointment of legal advisors who can demonstrate knowledge of the State of Jersey's legal regime and are able to prove expertise in public capital markets debt matters and have experience of recent relevant public bond transactions. |