STATES OF JERSEY

DRAFT PUBLIC FINANCES (AMENDMENT OF LAW No. 1) (JERSEY) REGULATIONS 201- (P.133/2013): COMMENTS

Presented to the States on 20th January 2014
by the Corporate Services Scrutiny Panel

STATES GREFFE

COMMENTS

Introduction

1. On 11th December 2013, the *Draft Public Finances (Amendment of Law No. 1) (Jersey) Regulations 201-* (P.133/2013) was referred to the Corporate Services Scrutiny Panel under Standing Order 72.

2. We have undertaken a short review of the draft Regulations, putting written questions to the Minister and meeting him at a public hearing. We have found that there is no reason why the debate on the draft Regulations should not continue and that they are consequent to previous decisions taken by the Assembly.

3. Our work focussed on 3 areas: the system of checks and balances that exists in relation to States lending; the use to which the £250 million (to be lent as part of the Housing Project) will be put; and the timetable for borrowing.[1] That work highlighted a number of pieces of information which we believe may be of interest to Members and which we have therefore set out below.

Context

4. The draft Regulations seek to amend Article 23(2) of the *Public Finances (Jersey) Law 2005*, which relates to the total amount that the States may lend. If they are adopted, the amount which the States can lend at any one time will increase from 15% to 60% of the estimated income of the States derived from taxation during the previous financial year. The Minister advised us that, on the basis of current figures (i.e. using 2012 figures), this would see the amount which the States could lend rise from £87.8 million to £351 million. Current States lending in fact only amounts to approximately £11.4 million (on the basis of the figures already discussed, less than 2% of estimated income). Only £250 million will be lent as part of the Housing Project. That would equate to approximately 43%, using those same figures. Increasing the limit to 60% will therefore mean that the States will retain the potential to lend approximately £100 million, even when lending for the Housing Project is implemented.

5. The figure for current States lending does not include situations where assistance has been provided by other means, for example, to the Parish of Trinity for the construction of affordable housing. That was classified as an investment of the Currency Fund, rather than as a loan in the context of the Public Finances Law.

Checks and balances

6. A number of comments were made during the initial debate on the draft Regulations about the checks and balances which would be put in place. Some Members were concerned that too much power might be placed within the hands of the Minister for Treasury and Resources. Approval of the draft

[1] By 'Housing Project' we refer to that part of the 2014 Budget in which the Assembly agreed to borrow £250 million and subsequently lend it on for social housing purposes.

Regulations would not in itself affect those powers (it merely affects the limits on States lending, as described above).

7. The Minister has advised that he would enhance the current system of checks and balances. During our review, the Minister spoke of his confidence in the current system and he provided us with a detailed explanation of that system. In his view, the current system would be sufficient to support lending for the Housing Project, but he nevertheless wished to strengthen it.

8. The first check, we were advised, was that approval of the States was required for lending to occur. That is required under Article 23(1) of the Public Finances Law although, under Regulations, the Minister has some discretion to lend relatively small amounts in limited circumstances (individual transactions of no more than £500,000 which must not total more than £3 million in one year and £10 million overall). But States approval is required for lending of the scale envisaged for the Housing Project.

9. That approval by the Assembly has already been given. As the Minister advised us, 2 decisions were pertinent in this regard. First, with the approval of *The Reform of Social Housing* (P.33/2013), the Assembly agreed that the Minister for Treasury and Resources should identify funding arrangements for the Housing Transformation Programme. The report accompanying that proposition stated that "*the Minister for Treasury and Resources has indicated that borrowing of up to £200 million over a 20 year period could be made available to the Housing Company at a fixed rate assumption of 5% per annum.*" It subsequently became apparent that, rather than the newly established housing company borrowing directly, it would be preferable for the States itself to borrow the required amount and to lend it on subsequently to the new company.

10. The second relevant decision was the Assembly's approval of the 2014 Budget, which included plans for the Housing Project. Of particular relevance to the draft Regulations currently before the Assembly, the Assembly approved the following –

> "*that, following the approval by the States on 16th May 2013 of the proposition "The Reform of Social Housing" (P.33/2013) and in accordance with the provisions of Articles 10(3)(b) and 21 of the Public Finances (Jersey) Law 2005, the States be authorised to borrow up to a maximum £250 million in 2014 for housing purposes and that, in accordance with the provisions of Article 10(3)(f) of the Public Finances (Jersey) Law 2005, the amount borrowed by the States be transferred from the consolidated fund to the Housing Development Fund; [and]*
>
> *in accordance with Article 3(3)(b) of the Public Finances (Jersey) Law 2005 that the purposes of the Housing Development Fund ("the Fund") be varied to enable the further provision and development of housing in Jersey and that the Fund be permitted to lend money up to a maximum £250 million to Housing Trusts/Associations/Companies or bodies with the same purpose registered in Jersey in order that they can provide social housing for islanders, on terms and conditions to be agreed, after consultation with the Minister for Housing,*

> *between the Minister for Treasury and Resources, and the aforementioned Housing Trusts/Associations/Companies.*"

For ease of reference, we have appended the entirety of that part of the 2014 Budget which related to the Housing Project. The Assembly has therefore already approved both the borrowing and lending of £250 million, subject to the caveats agreed as part of the Budget.

11. We were informed of other checks and balances. Once lending is approved by the States, if the Minister for Treasury and Resources is the approved lender (as is the case here), his Department manages the process and develops procedures to ensure lending is prudent and satisfies requirements. In that regard, there already exists a Financial Direction in respect of lending (Financial Direction 3.3) although the Minister advised us that a new Financial Direction would be issued in respect of lending for the Housing Project. This new Financial Direction would, according to the Minister, be in place before any loans were made.

12. The agreed wording of the 2014 Budget makes it clear that the borrowed £250 million for the Housing Project will be placed in the Housing Development Fund and subsequently lent from there. The lending will therefore be dictated by the purposes to which the States agreed in the 2014 Budget and also the underlying rationale of the Housing Development Fund, which was established in 1999 through the adoption of *Social rented and first-time buyer housing: proposals for future funding* (P.74/1999) and *Establishment of Housing Development Fund* (P.84/1999). P.84/1999 included a Schedule that explained the rationale underlying the Fund, whilst a description of the Fund's purpose was provided in R.31/2011 (copies of which we have appended).

13. The majority of the £250 million will be lent to the newly established company (to be named Andium Homes). The Minister advised us that a number of details remain to be agreed in relation to Andium Homes. Nevertheless, we were told that loan agreements would be reached with the company and that the company would be expected to undertake proper and appropriate business-planning. The Minister envisaged that he would review the business plan with the Minister for Housing, and that prior to any loans to Andium Homes being agreed, the Minister for Housing would be asked to affirm his support for the company's proposals; a "*consultation mechanism*" would therefore be put in place with the Minister for Housing.

14. The Minister also advised that consultation would occur with the Council of Ministers. In that regard, we were informed that the proposals of Andium Homes would be considered by the Council alongside the Capital Programme.

15. Any loans to Andium Homes will be signed off by the Minister for Treasury and Resources by way of a formal, published Ministerial Decision. Once drawn down, it was the Minister's expectation that the relevant funds would be managed by the new company itself. However, it is anticipated that the new company (and, indeed, any recipient of a loan) will be expected to provide quarterly compliance reports in order that there be certainty about their ability to meet capital repayments.

16. In terms of reporting, loan balances are reconciled at least quarterly by the Treasury, although monthly receipts will be reconciled on a monthly basis. The administration and request for payments is managed within the Department of Treasury and Resources, although for loans where there are monthly receipts, payments are collected through a third party. The Minister is legally obliged to report any new lending at periods of no more than 6 months in the Budget Management Report. We were advised that information on lending was not currently included within the Quarterly Finance Reports which are presented to the Council of Ministers (and which are shared with Scrutiny Panels and the Public Accounts Committee) although we were informed that such information could easily be included, if so desired.

17. All lending is also reported in the annual accounts of the States. Each fund from which loans may be made is dealt with individually in those accounts.

18. Beyond these checks and balances, there are also external bodies to consider, such as the Comptroller and Auditor General and the Public Accounts Committee, who can review and consider the work of the Minister and his Department in this area.

Use of the £250 million

19. Not all of the £250 million which will be borrowed as part of the Housing Project will subsequently be loaned to Andium Homes. £207 million will be loaned to Andium, although not immediately in its entirety: we were advised that drawdowns would effectively follow the funding schedule which was included in the 2014 Budget and which we have reproduced below –

2013	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**Total**
£0.3m	£61.7m	£28.8m	£41.5m	£36.7m	£20.8m	£9.7m	£7.7m	£207.2m

The first loan should therefore be in the region of £62 million and will, it is anticipated, be made in July 2014 once the new company has been set up. The Minister advised that the first tranche could potentially be greater, however, if Andium Homes were able to bring more projects forward. It should be noted that once the first loan is made, Andium Homes will be expected to begin immediately repaying the advances which the Department of Housing received in 2012 for the funding of capital projects. These repayments were factored into the Medium Term Financial Plan and relate to advances of some £11 million for Le Squez and Pomme d'Or Farm and £27.1 million agreed with the adoption of *Social Housing Schemes: funding* (P.40/2012).

20. In loan arrangements with Andium Homes, we were advised that the Minister and his Department would seek to cover costs and administration. It would not be logical to seek to make a profit, given that the company would be in full ownership of the States.

21. The remaining £43 million to be lent will be accessible, in the words of the 2014 Budget, by "*Housing Trusts/Associations/Companies or bodies with the same purpose registered in Jersey*". This £43 million was identified in the Budget as being required for provision for rezoned sites and site acquisition.

The Minister advised us that he was "*agnostic*" about the providers who would benefit, albeit that there would pragmatically speaking be 2 major providers of social housing: Andium Homes and the Jersey Homes Trust. Other bodies could potentially benefit, however, if they met the criteria. This could include the other Housing Trusts, Parishes and even, potentially, the States of Jersey Development Company (SoJDC). Loans would need to be in keeping with the conditions agreed by the Assembly and the provisions of the Housing Development Fund.

22. It was not possible during our work to determine which other bodies might benefit (some or all of the £43 million could also be loaned to Andium Homes, dependent upon the circumstances). No agreement had been reached with the Jersey Homes Trust, for instance, as there was no planning consent on which to base such an agreement. The Minister advised, however, that "*if the Jersey Homes Trust gets an agreement with a planning consent and SoJDC to deliver the affordable social units on [the former] JCG, then we have indicated to them that we would be minded to fund that because it is a cheaper form of borrowing than they would get by lending from the banks*."

23. Through the 2014 Budget, the Assembly agreed that loans would be made for the provision of "*social housing for islanders*." It is apparent, however, that this does not simply mean social rented housing. For example, the Minister advised us that "*social rented housing is one type of tenure but it is the aspiration of both the Minister for Housing and the Planning Department that there should be other tenures such as variants of right to buy, shared equity and other forms of low cost housing that allow people that otherwise would not be able to operate in the so-called open housing market to get into home ownership*." The Ministers for Housing, for Planning and Environment, and for Treasury and Resources would therefore work with the Strategic Housing Unit on this matter. In line with what the Budget had shown, the Minister also indicated that loans might be provided for the purchasing of sites: "*if there are rezoned sites and the Jersey Homes Trust or Andium need to buy those units, or acquire them and develop them*." Loans would not be used, however, to support the Starter Home Deposit Loan Scheme.

24. Given that loans to Andium Homes will be done in tranches and that the recipients of the remaining £43 million have yet to be confirmed, it is likely that some of the funds borrowed by the States will remain in the Housing Development Fund for a time. The Minister advised that any such surplus would be invested under a specific investment strategy agreed for the Housing Development Fund, although a risk-averse approach would be taken. This is in keeping with the Assembly's approval of the 2014 Budget, in which it was stated that the Housing Development Fund would be: "*invested through the Common Investment Fund in accordance with its own published investment strategy*." It would be useful, however, to have further information on the investment strategy to be applied to the Fund.

Borrowing Timetable

25. The sole focus of the draft Regulations is the level of lending which the States may undertake. Nevertheless, the lending is only one aspect of funding the Housing Project, the initial part of which will be the borrowing of £250 million (to be implemented through the issuing of a public rated bond).

We took the opportunity to question the Minister on the timetable for the borrowing to occur. Notwithstanding that the draft Regulations were referred to us under Standing Order 72, we understand that the Minister and his Department have continued preparatory work for the issuance of the bond in order to ensure it could be undertaken in good time.

26. The Minister underlined the need to move quickly in order that the States could take advantage of current borrowing rates, as the advice he had received was that interest rates would rise over the coming months. There remain a significant number of steps to be taken before the bond can be issued. We were advised of the Minister's intention that it would be issued by 21st April 2014. The Minister's aim is to borrow at the lowest possible cost for the longest period of time.

27. Before the bond can be issued, book-runners and lawyers need to be appointed; roadshows need to be arranged (and undertaken) in Edinburgh, London and Jersey; and further consideration will need to be given to how precisely the borrowing will occur. In that regard, we were informed that consideration was still being given to whether £250 million should be borrowed in one go, or whether it could be borrowed in 2 tranches. Such consideration would take into account the impact that borrowing in tranches might have on borrowing rates (particularly in respect of any second, later tranche). We were also informed that consideration would be given to whether a proportion of the borrowing could be done through the issuing of retail bonds. We were informed that the Minister had been advised that the issuing of retail bonds would in fact make the borrowing more expensive; nevertheless, it had not yet been dismissed that there could be a retail element of the bond. The final decision on these matters would be taken by the Minister for Treasury and Resources, following appropriate consultation.

28. In terms of repaying the borrowing undertaken by the States, the Minister advised us that a repayment fund would be built up within the Housing Development Fund in order that there would be sufficient monies to repay the bond investors upon maturity. We believe that Members would benefit from further information on how this will be achieved, and we would therefore ask the Minister to ensure that further clarification is provided.

29. The 2014 Budget provided an indication of the risks involved in borrowing for the Housing Project and the manner in which the Minister intended to mitigate those risks. We have reproduced them for Members' attention in an Appendix to these comments.

Conclusion

30. As we have stated, there is no reason why the debate on the draft Regulations should not continue. The Assembly has already approved the lending of £250 million for the Housing Project, and approval of the draft Regulations will allow that decision to be implemented.

31. We are grateful to the Minister and his Department for their assistance during our review. It enabled us to complete our work over the Christmas period and in good time. This work allowed for the useful confirmation and clarification of certain elements of the Housing Project. We recognise that there exists a

system of checks and balances in respect of States lending, and we support the Minister in his moves to enhance that system. Members can expect to see the results of those enhancements in due course; for instance, through the issuing of a Financial Direction which will be in force before the first loan is issued (anticipated at this time for July 2014).

32. The Housing Project is a significant one, and the scale of borrowing and lending is, in recent times, unprecedented. Given the significance of the project (and the concerns expressed by Members during the initial debate on the draft Regulations), we believe it vital that the Council of Ministers as a whole has a role to play. The Minister has already made it clear that the Council of Ministers (and, more particularly, the Minister for Housing) will be consulted and involved in decisions regarding the Housing Project. This is only right in our view. We would urge the Minister, however, to consider how the consultation and reporting mechanisms can be formalised in order that there is clarity for everyone that these important parts of the process have been fulfilled.

33. We leave it for the Minister to work on this matter although, from our review, some possible minor developments are apparent. All lending for the Housing Project will be signed off by the Minister for Treasury and Resources in a formal, published Ministerial Decision. It is to be expected that those Ministerial Decisions will each refer to the consultation undertaken with the Minister for Housing and with the Council of Ministers, explaining how and when it occurred. It may be, for instance, that the Minister for Housing could issue his own separate Ministerial Decision in respect of loans in order that there is clarity about his support.[2]

34. In relation to the Council of Ministers, irrespective of the discussions which the Minister will undertake with his colleagues, we would recommend that borrowing and lending for the Housing Project is included in the Quarterly Finance Reports which the Council already receives.

[2] Ministerial Decisions by more than one Minister in relation to a particular issue are not unusual – they occur already in respect of budget transfers.

APPENDIX 1

Extract from 2014 Budget relating to Housing Project

With the approval of *Draft Budget Statement 2014* (P.122/2013), as amended, the States agreed under paragraph (e) of the proposition to the following –

"*(i)* *that, following the approval by the States on 16th May 2013 of the proposition "The Reform of Social Housing" (P.33/2013) and in accordance with the provisions of Articles 10(3)(b) and 21 of the Public Finances (Jersey) Law 2005, the States be authorised to borrow up to a maximum £250 million in 2014 for housing purposes and that, in accordance with the provisions of Article 10(3)(f) of the Public Finances (Jersey) Law 2005, the amount borrowed by the States be transferred from the consolidated fund to the Housing Development Fund;*

(ii) *in accordance with Article 3(3)(b) of the Public Finances (Jersey) Law 2005 that the purposes of the Housing Development Fund ("the Fund") be varied to enable the further provision and development of housing in Jersey and that –*

(A) *the Fund be permitted to lend money up to a maximum £250 million to Housing Trusts/Associations/Companies or bodies with the same purpose registered in Jersey in order that they can provide social housing for islanders, on terms and conditions to be agreed, after consultation with the Minister for Housing, between the Minister for Treasury and Resources, and the aforementioned Housing Trusts/Associations/Companies;*

(B) *all administrative costs associated with the operation and maintenance of the activities of the Fund to be paid out of the Fund;*

(C) *the fund to be invested through the Common Investment Fund in accordance with its own published investment strategy;*

[and that subject to sanction by Her Most Excellent Majesty in Council and the subsequent coming into force of new Articles 3(3)(aa) and 3(3)(ab) of the Public Finances (Amendment No. 4) (Jersey) Law 201-]

(D) *all money due to the Fund, including any loan repayments and interest due from Housing Trusts/Associations/Companies, be credited to the Fund;*

(E) *money credited to the Fund does not form part of the annual income of the States*."

APPENDIX 2

The Housing Development Fund

Operation of the Housing Development Fund (HDF) (taken from P.84/1999)

1. The current Housing Development Scheme is an ongoing fund set up to provide the Housing Committee with bridging finance to develop properties for onward sale. The Scheme bears the cost of land acquisition and development, which is then recovered on the disposal of completed sites.

2. The HDF would extend the Housing Development Scheme to include funding for the development of social rented housing as well as for first-time buyer properties.

3. The HDF would provide a mechanism for funding housing developments undertaken by the States, as well as providing subsidies (where necessary) for developments undertaken by other providers of social rented housing (such as Housing Associations) and, if necessary, for certain private sector “first-time buyer schemes”.

4. The nature of the HDF’s operation is such that funds would flow out of the account in the early years to be repaid over the longer term, leaving the Fund initially in a deficit position. This deficit would require financing and it is proposed that this is achieved through –

    - refinancing the Dwelling Houses Loans Fund (DHLF), to release cash of some £22 million (based on the DHLF’s 1998 balance), which could be used in the short term;

    - direct external borrowing (the extent of this would depend upon the level of involvement from Housing Associations in the development programme).

5. The existing agreement with Housing Trusts provides an interest subsidy that caps the repayment rate for Trust borrowing at 4% per annum. Capital development subsidies are also made where rental levels are too low to sustain the scheduled repayment. For this reason funding, in addition to that raised from rental income gained on the new housing units, will be required to ensure the fund is fully repaid. It is proposed that these subsidy arrangements are extended to include developments undertaken by the Housing Committee as well as those undertaken by Housing Trusts.

6. The forward financial forecast presented to States’ Committees on 20th May 1999 includes a preliminary allocation of £10 million per annum to be added to the amount available for capital expenditure. This amount, or such other amount as the Finance and Economics Committee considers appropriate, is to be earmarked for transfer to the HDF.

7. The borrowing liability of the HDF would then need to be repaid. The funding to meet the repayments would be realised from a number of sources –

- allocations from the Capital Fund as earmarked and referred to in paragraph 6 above;

- an annual transfer from the Housing Committee Revenue Budget, based on a proportion of the rental income gained from the new units to be developed and added to that Committee's stock;

- any 'surpluses' from first-time buyer sales. Where a first-time buyer development is undertaken on land already in States' ownership, the sale price for those properties may exceed the cost of development. It is proposed that, in such cases, the net 'surplus' be allocated to the HDF to offset schemes where a development subsidy is required;

- as the HDF develops, the Finance and Economics Committee would consider such alternative means of funding as may be considered appropriate.

Purpose of the Housing Development Fund (taken from R.31/2011)

"*The Housing Development Fund's purpose is –*

> *'To help meet the requirements for the development of social rented and first-time buyer homes as identified in the 'Planning for Homes' report (R.C.10/99), which was updated in December 2006 (R.C.94/2006) and subsequent strategic reports, primarily in the urban area, to a good standard and specification at a reasonable cost'.*

The Housing Development Fund does not fund the whole cost of a housing scheme, but provides the Housing Committee with bridging finance to develop properties for onward sale. The scheme bears the cost of land acquisition and development which is then recovered on the disposal of completed sites.

The Housing Development Fund provides a mechanism for funding housing developments undertaken by the States, as well as providing subsidies (where necessary) for developments undertaken by other providers of social rented housing (such as Housing Associations) and, if necessary, for certain private sector 'first time buyer schemes'. In the case of first-time buyer properties it provides an interest subsidy to enable the cost of the scheme to be repaid from its rental stream or sales receipts. The States approved P.74/99 and P.84/99 on 7th July 1999 and thereby the creation of the Housing Development Fund to be administered by the former Finance and Economic Committee.

The Housing Development Fund provides interest subsidy for those Housing Trust properties acquired under the former Housing Development Scheme Account and supports the development of social rented housing on rezoned sites by capping the interest liability of Housing Trusts to a maximum of 6%."

APPENDIX 3

Extract from the 2014 Budget relating to the Risks in respect of Bond Issuance

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.