STATES OF JERSEY

FUTURE HOSPITAL FUNDING STRATEGY (P.130/2016): THIRD AMENDMENT

Lodged au Greffe on 4th April 2017
by the Corporate Services Scrutiny Panel

STATES GREFFE

FUTURE HOSPITAL FUNDING STRATEGY (P.130/2016): (AS AMENDED) THIRD AMENDMENT

1 PAGE 1, PARAGRAPH (b) –

Delete the words "and to approve the Fund's purpose, terms of reference and operation as set out in the Appendix to the report accompanying this proposition;" and substitute the words –

> "the terms of reference for which are to be brought forward by the Minister for Treasury and Resources for approval by the States Assembly at a later date;".

2 PAGE 1, PARAGRAPH (c) –

Delete paragraph (c) and renumber the remaining paragraphs accordingly.

3 PAGE 1, PARAGRAPH (d)(i) –

After the words "States Assembly" delete the remaining paragraph and substitute the words –

> "and a compensating payment into the Strategic Reserve from the Consolidated Fund will be made each year in order to recapitalise the Strategic Reserve Fund which will be funded through a mechanism to be proposed by the Minister for Treasury and Resources and subject to approval by the States Assembly;".

4 PAGE 1, PARAGRAPH (d)(ii) –

After the words "in agreeing to", delete the words "the borrowing specified in paragraph (c)" and substitute the words "(d)(i)".

5 PAGE 1, PARAGRAPH (d)(iii) –

Delete paragraphs (d) (iii) and (d)(iv) and renumber the remaining paragraphs accordingly.

CORPORATE SERVICES SCRUTINY PANEL

REPORT

The principal purpose of this amendment is to allow States Members to debate, and properly decide on whether they want to fund the new Hospital project through external borrowing (e.g. via a bond) or through internal funding (e.g. the Strategic Reserve). This Amendment provides Members with a clear alternative option.

From the work we have performed – which will be identified in the report we will be issuing before the debate on P.130/2016 – the proposals from the Council of Ministers are not, at first glance unreasonable, if external borrowing is considered the best way forward.

The Minister for Treasury and Resources is seeking to borrow up to £400,000,000 by issuing a bond to the markets, to fund the cost of the Hospital Project. It is likely that the interest rate on the bond will be somewhere between 2.75% and 3%, which will represent an annual interest charge of between £11,000,000 and £12,000,000, for the entire life of the bond. At present it is expected that this will be 40 years, therefore the total interest charge will be between £440,000,000 and £480,000,000 over and above the amount of capital that will have to be repaid (of £400,000,000).

The Treasury Department consider that this can all be met from the Strategic Reserve, particularly in the context of historically low interest rates and the level of past returns that have been achieved by the investments held in the reserve.

They have considered various scenarios, and many of them do show satisfactory results in this regard.

One-off shocks to the investment performance of the Strategic Reserve indicate that the main underlying capital of the Reserve can be retained. The total value of the Strategic Reserve was stated in P.130/2016 as being £866 million at the end of October 2016.

The Panel's principal concerns relate to other scenarios considered by the Treasury Department. These are scenarios which consider what happens when there is a permanent change in certain circumstances.

The Panel has seen evidence that should investment returns fall by as little as 1.5% from those assumed by the Treasury Department, there will be a significant impact on outcomes. This is particularly the case if another event was to occur at the same time (for example a cost over run on the project).

This evidence further suggests that a structural fall in overall States revenues of as little as 3.5%[1] would result in very little remaining of the Strategic Reserve. In the event that there was a structural fall in revenue of between 4% and 5% (approximately) this would wipe out the Strategic Reserve within 25 years, and would create a deficit of £1,356,220,000 (£1.356 billion) within 40 years.

It is this evidence, and its analysis of how extremely sensitive the strategy is to relatively minor changes in income forecasts, that has significantly influenced the views of the

[1] This assumes this generates deficits which would have to be funded from the Strategic Reserve.

Panel. This is why the Panel is of the opinion that States Members should be given an alternative funding option to debate and vote upon.

It is clear that at this moment in time, the Island (and the United Kingdom, as well as Europe) are in the most uncertain position both economically and politically, for the last 70 years. No-one at this stage can predict the outcome of the Brexit negotiations, and the structural impact they will have on our revenue and tax base. This could arise out of direct financial pressures, a change in the nature of the financial services industry, or even greater political pressure (with a consequential financial impact). Given the uncertainty, the Panel believes that it is sensible to consider what happens should a less than favourable situation arise.

A further concern that the Panel has, is that States Members are being asked to make a decision without being provided with an overview of the total liabilities of the States.

Following a preliminary calculation by the Panel, as set out below, members should consider the Treasury Department proposals in light of adding to an already considerable level of liabilities.

	£'000
PECRS Pre-1987 Past Service Liability	274,619[2]
Provision for JTSF Past Service Liability	104,452[2]
Finance Lease Obligations	4,698[2]
Andium Bond	250,000
Sub-total	**633,769**
Other Liabilities (estimated)	
SOJDC	74,000
Hospital Bond	400,000
Sub-total	**1,107,769**
Note : In addition there are known to be the following total interest obligations:	
Andium:	
250M @ 3.75% for 40 years[3]	
[£9.375 million per year]	375,000
Hospital (estimated) :	
400M @ 2.75% – 3% for 40 years	
[£11M – 12M] per year	440,000 – 480,000
Total	**1,922,769 – 1,962,769**

The Panel are concerned as to the magnitude of the liabilities that the States already needs to service, and the impact that a bond of this size would have in increasing such liabilities.

The Panel considers that there is an alternative option that States Members should consider. That is, to utilise the funding already available to the States from the Strategic

[2] Per States Accounts – year ended 31St December 2015
[3] Note: This represents total life of bond, some of which has already expired.

Reserve and to introduce a mechanism by which this can be recapitalised. It should be noted that the Treasury Department did model the concept of utilising funding from the Strategic Reserve, but did not model the subsequent recapitalisation.

Precise calculations are still awaited by the Panel. Our initial calculations indicate that the annual sum required (in present day terms) would be between £5 million and £7 million per year (to be uplifted annually by the Cost of Living).The Panel has not specified the exact amount in the Amendment, because rightly this should be left in the hands of the Minister for Treasury and Resources to determine. The Panel considers that the objective should be to recapitalise the Strategic Reserve to the level that is the estimated target under the present proposals of issuing a bond for £400,000,000.

The Panel do not consider a proposal to pay a minimum of £5 million – £7 million per year (uplifted by cost of living) into the Strategic Reserve Fund, to be an onerous task. In fact it seems highly realistic. For example, carry forwards over the last 4 years average over £25 million. It would mean that there was no debt to service (of £11 million – £12 million per year) and it would mean there was no capital to repay (of £400 million).

In summary

Given that a favourable outcome (from issuing a bond) could be reversed by relatively small permanent changes in income forecasts or returns on investment, the Panel therefore considers that an alternative should be available to States Members for debate on 18th April 2017.

The choice being presented is therefore to borrow £400,000,000 externally from the markets; or to use our own funds. This avoids having to repay £400,000,000 of capital AND over £400,000,000 in interest over the period, but requires a commitment to a small annual payment in order to top up the capital balance. The Panel considers this to be a more far-sighted and prudent strategy, which acknowledges the inherent dangers of borrowing large sums of money, exacerbated by the uncertain economic climate in which we find ourselves. We therefore offer this amendment to Members, to give them a valid option to funding the future hospital.

Financial and Manpower Implications

There are no manpower implications created by this amendment.

There would be a financial commitment to pay into the Strategic Reserve Fund a sum of money (to be subsequently determined by the Minister for Treasury and Resources). However, the Amendment would remove the commitment to pay both the annual interest and the final capital figure on the proposed borrowing.

Note:
A copy of the "as amended" version of P.130/2016 can be found via this link (P.130/2016 – 18th January 2017)