STATES OF JERSEY

MAINTENANCE OF JERSEY'S CREDIT RATING

Lodged au Greffe on 10th February 2022
by Deputy K.F. Morel of St. Lawrence
Earliest date for debate: 29th March 2022

STATES GREFFE

PROPOSITION

THE STATES are asked to decide whether they are of opinion –

(a) that, for any issuance of debt proposed in a Government Plan, the Plan should include a forecast of the likely effect of the debt on Jersey's future credit ratings, and the rates of interest that would be levied on the debt;

(b) that, except in periods of emergency, the Minister for Treasury and Resources should ensure that the Government of Jersey's long-term credit rating should be maintained at a level of BBB or above (Standard & Poors) or the equivalent for other ratings agencies; and

(c) to request the Minister for Treasury and Resources to bring forward any changes to the Debt Framework, or other related policies, with a view to presentation to the States Assembly no later than 30th April 2022.

DEPUTY K.F. MOREL OF ST. LAWRENCE

REPORT

The States of Jersey has approved the borrowing of significant sums (approximately £1.7 billion) to finance a range of activities such as social housing, payment of pension liabilities, emergency covid funding and the construction of a new hospital. Naturally, these funds attract interest rates which lenders assess according to the Government of Jersey's credit rating. Credit ratings agencies determine the rating level by looking at a range of factors such as but not limited to the net asset value of the Government, strength of income streams and the wider economic outlook for the island.

In order to ensure Jersey's debt burden does not become unserviceable, the Minister for Treasury and Resources has published a Debt Framework (R.132-2021). This framework includes self-imposed restrictions and measures such as:

- "to achieve a medium-term debt-to-GDP ratio in a range of between 30% and 40%";

- "to achieve a liquid asset to GDP buffer in excess of 100%";

- "aim to maintain a coverage ratio of at least 1.0 for financing costs that are met from reserves, meaning that investment returns are greater than financing costs. For financing costs met from general revenues we will aim to ensure that those costs are less than 5% of total revenues"; and

- "to maintain an investment grade rating (BBB- and above) under all market conditions".

It is the last of these "Key Reporting Metrics" that this proposition seeks to change, for the following reasons:

- As Covid has shown, future periods of emergency or crisis may necessitate the Government to borrow in order to fund the Island's safe passage through that period. Such periods are generally of unknown length, this is proven both by Covid and the Occupation, which at the outset had to be treated as likely to continue indefinitely.
- In a period of emergency or crisis, the Government will likely have to borrow at short notice and in considerable amounts, meaning that it will be in a weak position to negotiate favourable interest rates and will be unlikely to have sufficient time to strengthen its balance sheet in order to secure lower interest rates.
- The investment grade rating of BBB- that the Government currently aims to maintain is the **lowest investment grade rating available**. Ratings below this level are considered to be "non-investment grade speculative" or "junk" investments. As such, borrowers with these ratings attract significantly higher interest rates.
- If, at a time of emergency, Jersey needed to borrow in order to finance its transition through that period and was going to the markets with the lowest possible investment grade rating, then it is clearly possible that the extra borrowing would push the island into the "junk" category of investment.
- Such a situation would see Jersey paying significantly higher interest rates than if it had maintained an investment grade rating. It is even possible that Jersey could be denied credit if its rating was seen as likely to fall too far.

The current Debt Framework leaves the Island without any buffer between its minimum acceptable credit rating and “junk” ratings. This proposition installs a buffer during normal times of borrowing and therefore means that the Island will be much more likely to avoid falling into “junk” territory in an unexpected period of emergency and so, should it need to borrow funds rapidly to deal with a crisis, it will be able to do so without being pushed into a credit rating that will attract far higher rates of interest or even find that it is unable to borrow.

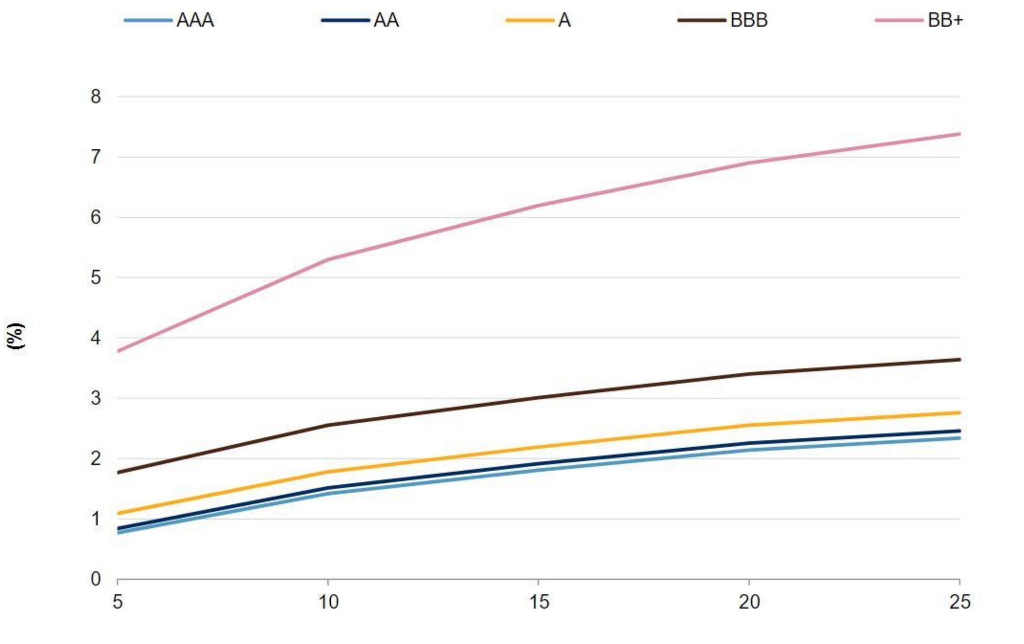
Because at their outset, periods of emergency or crisis are generally of indeterminate length, this proposition does not seek to restrict the credit rating during such a time. A crisis that lasts for a decade may mean the Island has to borrow such large sums that it cannot avoid falling into “speculative” investment territory.

However, during periods of normality, the Island will be far better placed to respond to an unexpected crisis if it is certain that at the period’s outset, it is safely within the scope of “investment grade” credit ratings and will remain so even after the first round of unplanned borrowing.

This is a prudent approach to borrowing that is not reflected in the current Debt Framework’s approach to credit ratings.

The Effect of Credit Ratings on Bond Yields

U.S. Corporate Bond Yields By Maturity



Data as of Aug. 12, 2020. Source: S&P Global Ratings Research.

The chart above gives a clear indication of the difference in yield (or interest rate) that differently rated bonds attract.

The pink line is the first level of “non-investment speculative” bonds, whereas the black line is the level of investment grade rating that this proposition seeks to ensure the Treasury Minister has to maintain.

The chart indicates that in 2020, the difference for long-term 25-year bonds amounted to more than 4%. On a £100 million bond, that would equate to an extra £4 million per year being paid in interest.

The Effects of Maintaining a Higher Credit Rating

Should this proposition be adopted, during normal times the Treasury Minister would have a number of options available should it appear that Jersey’s credit rating was going to fall below the BBB “investment grade” level. These include but are not limited to:

i) Refraining from entering into new borrowing;
ii) Reducing the level of borrowing;
iii) Increasing the Government’s net asset value e.g. strengthening reserves.

By supporting this proposition, States Members will be ensuring that Jersey is able to access credit markets during unexpected times of emergency or crisis without being penalised by significantly higher interest rates and without the fear that lenders will be scarce or even non-existent.

This proposition requires the current and future Treasury Ministers to adopt a highly prudent approach to debt and will ensure that the Island is unable to become “addicted to debt”.

This proposition represents a prudent and reasonable response to concerns that debt will become the norm in Jersey whilst also providing the Government with the ability to borrow whatever is needed during times of emergency.

Financial and manpower implications

There are no financial (in terms of direct costs) and manpower implications to this proposition should it be adopted.

Appendix

The ABCs of rating scales

S&P Global Ratings credit rating symbols provide a simple, efficient way to communicate creditworthiness and credit quality.

Our global rating scale provides a benchmark for evaluating the relative credit risk of issuers and issues worldwide.

General summary of the opinions reflected by our ratings

Investment Grade	AAA	Extremely strong capacity to meet financial commitments. Highest rating
	AA	Very strong capacity to meet financial commitments
	A	Strong capacity to meet financial commitments, but somewhat susceptible to adverse economic conditions and changes in circumstances
	BBB	Adequate capacity to meet financial commitments, but more subject to adverse economic conditions
	BBB-	Considered lowest investment-grade by market participants
Speculative Grade	BB+	Considered highest speculative-grade by market participants
	BB	Less vulnerable in the near-term but faces major ongoing uncertainties to adverse business, financial and economic conditions
	B	More vulnerable to adverse business, financial and economic conditions but currently has the capacity to meet financial commitments
	CCC	Currently vulnerable and dependent on favorable business, financial and economic conditions to meet financial commitments
	CC	Highly vulnerable; default has not yet occurred, but is expected to be a virtual certainty
	C	Currently highly vulnerable to non-payment, and ultimate recovery is expected to be lower than that of higher rated obligations
	D	Payment default on a financial commitment or breach of an imputed promise; also used when a bankruptcy petition has been filed or similar action taken

Ratings from 'AA' to 'CCC' may be modified by the addition of a plus (+) or minus (-) sign to show relative standing within the major rating categories.

guide_to_credit_rating_essentials_digital.pdf (spglobal.com)