STATES OF JERSEY

JERSEY INTERNATIONAL FINANCE CENTRE: FINANCIAL VIABILITY (INTERIM REPORT) (S.R.7/2015) – RESPONSE OF THE MINISTER FOR TREASURY AND RESOURCES

Presented to the States on 13th January 2016
by the Minister for Treasury and Resources

STATES GREFFE

JERSEY INTERNATIONAL FINANCE CENTRE: FINANCIAL VIABILITY (INTERIM REPORT) (S.R.7/2015) – RESPONSE OF THE MINISTER FOR TREASURY AND RESOURCES

Ministerial Response to:	S.R.7/2015
Ministerial Response required by:	11th December 2015
Review title:	Jersey International Finance Centre: Financial Viability (Interim Report)
Scrutiny Panel:	Corporate Services

INTRODUCTION

The Minister welcomes the report of the Panel's expert advisers, EY. Their findings confirm the basis on which the Jersey International Finance Centre (JIFC) development has been planned and undertaken to date.

The Minister has difficulty in reconciling the findings and recommendations of the Panel's report with those of their expert adviser. For that reason, he is unable to agree with a number of the Panel's findings, or to accept 2 of their 3 recommendations.

The Minister would welcome further explanation and provision of evidence by the Panel to substantiate the conclusions they have drawn from their adviser's work.

In particular the Minister wishes to make the following points in his response –

- The Panel makes much of comparing the States of Jersey Development Company's (SoJDC's) delivery of the JIFC development with how the private sector would have approached a similar project. To do so displays a fundamental misunderstanding of the purpose of SoJDC. The Company's purpose is to act as the delivery vehicle for property development for the States of Jersey, and in so doing, to deliver socio-economic benefits for the Public of Jersey, where land or existing developments are no longer required for States purposes. P.73/2010 clearly set out that the company would deliver regeneration projects within development plans approved by the Regeneration Steering Group. The purpose of SoJDC is not solely to deliver profit, in the same way as a private developer appraises and delivers projects. It lends consideration to the wider and longer-term economic benefits to the Island of its projects, in a way that a private developer would not be required to do. In order to safeguard the interests of the taxpayer, the company operates a risk mitigation process that requires the costs of construction for each building to be covered by legally binding pre-let agreements – that being the value of the completed building with the level of initial pre-let will exceed the value of the borrowing. This is the case with Building 4, and will continue to be the case for all buildings within the JIFC. The phased approach was recognised in the Minister Planning and Environment's revision to the Masterplan in 2011.

- It is interesting to note that the first item in the Panel's terms of reference for their review is "to consider whether the 2008 Masterplan for the Esplanade Quarter continues to represent the best socio-economic value to the States of Jersey on behalf of the Public of the Island." Paragraph 2(a) of those terms of reference requires an assessment of whether the Minister for Treasury and Resources has undertaken "an up to date assessment of the benefit to the Island of the proposed Jersey International Finance Centre". The Panel would appear to have lost sight of these socio-economic benefits when publishing its interim report. The Minister considers that the wider benefits of the JIFC, whilst difficult to quantify, far outweigh the simple profit calculations relating to Building 4. He considers that more weight could have been given to the evidence from, for example, Jersey Finance, of the need for Jersey to remain an attractive destination for the world's mobile financial services businesses and to invest in infrastructure. Ernst and Young, in the Executive Summary to their report, clearly agree with this view. They state –

    - "we also consider that this weak profit performance is not a reason alone to not proceed with the development"; and

    - "we believe it is appropriate to embark upon this first step, largely as a catalyst to the commencement of this regeneration project which is so important to Jersey".

- These statements indicate their understanding of the Minister for Treasury and Resources' position that the success of the JIFC development cannot be measured through profit alone. The wider benefits to the future of the Island are incalculable; the potential consequences of not proceeding are unthinkable. It is impossible to say whether a private developer would have proceeded with the development of Building 4 at this time, although other developments in the vicinity are visibly proceeding. Such a debate is of little benefit, given that SoJDC are, in any case, proceeding in accordance with their required risk mitigation measures, which mean that sufficient pre-lets have been secured to fund construction costs. They are also required to proceed with the significant obligation to provide public realm and parking that a private developer would not have to consider. The development sends an important signal of the Government of the Island's commitment to the future of its most important industries, whilst minimising financial risk to Islanders. The Minister is disappointed that the Panel is not able to recognise and support the development as an investment in the future of all Islanders, not just those working within financial services. Scrutiny has a vital role to play in the Island's government and its views, quite rightly, influence the opinions of States Members, interested parties and the Public alike.

- The Minister welcomes properly researched and evidenced scrutiny of the exercise of his powers and responsibilities, and is hopeful of further constructive dialogue with the Panel to move towards a shared understanding of what an exciting and pivotal innovation the JIFC represents in the Island's history. Most jurisdictions would embrace and offer enthusiastic support for Government-led intervention, carried out with minimal financial risk, to safeguard future jobs and standards of living for all inhabitants. The Minister will always have regard to the work of the scrutiny function, but he and the Council of Ministers are absolutely committed to the importance of the JIFC.

FINDINGS

	Findings	Comments
1	The JIFC as presently planned is not considered viable.	The Minister is satisfied that the JIFC is viable and the EY report, with its conservative position on rent and yield, suggested that the first building, No. 4 JIFC, will generate a profit of £3 million. The SoJDC viability assessment predicts the building will generate a return of £7.5 million. The EY report also suggests that Building 5 should be progressed on a similar basis of viability. The JIFC development as a whole is being progressed on a prudent, phased basis, which assesses viability at each stage. This is entirely in accordance with the wishes of the States expressed in P.73/2010, and the revised Masterplan. The DTZ/C&W report forecasts a £332 million gross development value (excluding public car park) against JDC gross costs that supports the long-term viability. As an example of the Minister's concerns over how the Panel has arrived at its conclusions, the EY report (page 53) states: "We have severe reservations as to whether there will be sufficient demand to enable full development of the full JIFC proposals totalling 480,000 sq. ft. of office accommodation over the medium term, of say 5–10 years". Based on this, the Panel say the "JIFC as presently planned is not considered viable". The Minister considers this to be an emotive statement which does not recognise the careful, phased approach that is being taken by SoJDC, and does not serve to foster constructive dialogue and evaluation by those reading the Panel's output.
2	The JIFC is unlikely to fund the cost of the planned replacement underground car park.	Adopting the figures from the EY report, a 67,000 sq. ft. building will generate a net return of £3 million. If this level of return is extrapolated over the 470,000 sq. ft. of the JIFC, it would generate a return of £21 million. The costs of the underground public car park and the community open space associated with the JIFC are estimated at £27 million. However, the public car park would have a completed value of £10 million. It is therefore entirely appropriate for an income-producing asset to be part-funded by debt finance and, as such, based on the EY figures and the aforementioned assumptions, the Minister is satisfied that the JIFC can fund all public infrastructure associated with Phase 1 of the Esplanade Quarter Masterplan.

	Findings	Comments
3	It is highly improbable that the JIFC will generate the stated return of £50 million (or higher).	SoJDC commissioned BNP Paribas Real Estate to carry out a development appraisal of the JIFC development in March 2014, and this forecast that the JIFC would generate a net profit of £55 million (in today's costs/ values). The Minister has recently commissioned an independent Red Book Valuation from DTZ (now Cushman & Wakefield), which forecast a gross development receipt of £332 million (excluding the public car park). When the total JIFC development costs are deducted, it projected a return in excess of £95 million excluding the value of the public car park. These receipts will be received over the development period, which is expected to conclude at or around the year 2026. Depending on the applied discount rate, the Net Present Value would provide a similar level of return to that identified in the BNP appraisal. The Minister is entirely satisfied that the expected return is forecast to be as stated by 2 pieces of work from industry experts.
4	The valuations undertaken by both DTZ (April 2015) and BNP Paribas Real Estate (March 2014) do not examine viability and development risk.	The valuation undertaken by DTZ for HSBC was to satisfy the bank's requirements prior to an offer of provision of funding. The C&W/DTZ report recently commissioned by the Minister is a Red Book Valuation carried out in accordance with the RICS Valuation Professional Standards. As with all valuations, this used market evidence. Furthermore, as it was projected some time into the future, certain assumptions also needed to be applied. The BNP Paribas Real Estate development appraisal did assess viability, and performed various sensitivity analyses on the major inputs to the financial model.
5	The development of B4 by the States of Jersey Development Company (''SoJDC'') is without doubt speculative in nature, contrary to undertakings previously given regarding '<u>minimal</u>' risk to the Public.	The Minister is satisfied that the construction of Building 4 is not "speculative". That term, in itself, is considered by the Minister to be emotive and not helpful in achieving a balanced and reasoned perspective on the JIFC. EY do not appear to use this description, and the Minister would welcome further justification by the Panel of their choice of words. The Panel's view is difficult to reconcile with that of their advisers. The development is being progressed on a building-by-building basis only when a significant legally binding pre-let has been entered into. The total value of the first building, when completed with the current level of pre-let, will be greater than the total borrowings that SoJDC is taking out to fund this phase of the development, and therefore even if no other tenant signed up, the building could be sold on completion and the debt cleared. This is

	Findings	Comments
		not, however, SoJDC's intention. SoJDC intend to fully tenant the building and hold until first rent review, 3 years after practical completion. This is a standard industry approach in Jersey.
6	There are severe reservations as to whether there will be sufficient demand to enable development of the full JIFC proposals over the medium term (5–10 years).	Forecasts of demand for office accommodation will vary according to the differing perspectives and level of optimism of those commenting. The Minister is satisfied that sufficient evidence exists, obtained from Jersey Finance and the level of interest from prospective tenants, to progress Buildings 4 and 5 and to plan for delivery of the remainder of the JIFC. Masterplans are living documents that need to be flexible and adjust to market requirements. SoJDC is carrying out the JIFC development on a phased, building-by-building basis: this will allow for flexibility in delivery if necessary.
7	It is considered highly unlikely that a private developer would undertake the development of B4, as the profit margins and risk factors are not at a level at which such a development would normally be undertaken.	This finding appears to be based on the conservative rents and yields applied by EY. SoJDC is of the view, supported by independent red book valuations, known out-turn costs and its disposal strategy, that B4 will generate a return of £7.5 million. The opinions of valuers will differ. HSBC have clearly taken a view that the project risks are outweighed by anticipated returns, to the extent that they are prepared to make development finance available to SoJDC. The amount that a developer would pay for the site and the level of public realm requirements beyond the 'normal' Planning conditions and obligations imposed, would also be a key factor in any developer's decision. The conclusion of the Panel's advisers is that Buildings 4 and 5 should be actively progressed. The Minister supports this position.
8	The likely 'profit' of B4 (i.e. completed development value assuming fully let less development costs but with no allowance for land value) produces an estimate of £3,040,000, before costs of contamination.	This finding appears to be based on the conservative rents and yields applied by EY. SoJDC is of the view, supported by independent red book valuations, known out-turn costs and its disposal strategy, that B4 will generate a return of £7.5 million.

	Findings	Comments
9	This ‘profit’ of £3,040,000 is significantly lower than previously, publicly reported returns for B4.	This finding appears to be based on the conservative rents and yields applied by EY. SoJDC is of the view, supported by independent red book valuations, known out-turn costs and its disposal strategy, that B4 will generate a return of £7.5 million.
10	The Panel notes that the £3,040,000 does not include the following items: (a) provision for the value of the land; (b) the actual incentives provided to UBS, but does reflect ‘market’ rental incentives; (c) provision for decontamination costs of the site; (d) provision for the write-off of costs incurred by SoJDC of between £2.6 million and £2.9 million in respect of B1, B2, B3, B6, the public realm and possibly B5 if the scheme does not proceed as envisaged; (e) provision for any proportion of costs incurred in producing the Esplanade Quarter Masterplan; (f) provision for any element of operating costs arising within SoJDC (e.g. management	(a) At this level of profit there would be no residual land value (b) The EY report does not state it has used “market” rental incentives for the purposes of its valuation/ viability assessment. On pages 24 and 25, EY list the rent-free element of the incentives provided on 37 Esplanade that ranged from 9 to 15 months. On page 47, EY details that Rent-Free of 18 –24 months has been allowed for within its valuation of No. 4 JIFC. [On page 48 it states under the sub-heading other tenant incentives, “These can take the form of either or both capital contribution to enhance fit-out, stepped rental and ‘take backs’ of the tenant’s existing leases. Our analysis assumes no further tenant incentives other than the rent frees referred to above.”] On page 14 of the EY report it states: “Whilst our analysis is informed by the information provided by SoJDC, we have not specifically referred to it in the body of this report in order to comply with the agreed NDA”. On page 6 of the EY report it states: “We assess the gross development value of Building 4, net of purchaser costs (i.e. reflecting the anticipated sale price), assuming a stabilised rental profile (i.e. all rent-frees ‘washed’ through) of £32.65 million. In other words, this is our view of the potential price at which the building could be sold once complete and fully income-producing.” SoJDC has publicly disclosed that it will hold these office buildings for 3 years after the completion of the build. This will ensure that all rent-free periods are wound out and that SoJDC benefits from any uplifts at first review. There is nothing uncommon about this strategy – Dandara has now held 37 Esplanade for at least 24 months since first occupation. SoJDC will have to bear the interest costs of holding the building for 3 years. However, the rental-stream that will flow on expiry of the rent-free periods will exceed the cumulative hold cost

	Findings	Comments
	costs) that relate to the JIFC project.	and any other incentives that JDC may have given. (c) EY was provided with figures up to the date of concluding its report, and furthermore the EY figures included a 2.5% contingency figure which would take into account such unforeseen costs. The most recent SoJDC cost assessment, including contamination costs, confirms that the estimated cost of building No. 4 is within the overall cost position stated in the EY report; (d) These are not part of the costs of Building 4. (e) These costs have no relevance to SoJDC. (f) The EY report includes professional fees of 10%. SoJDC has professional fees of 8% and therefore provides a budget sum for a 2% management fee for SoJDC.
11	SoJDC must demonstrate to the States Assembly that the scheme for B4 will deliver no loss to the public purse, taking account of the effect upon profit of any rent free or equivalent tenant incentives (both agreed and proposed), together with due allowance for all known and planned costs of delivery.	There is no requirement for SoJDC to demonstrate this to the States Assembly. SoJDC's relationship is with the Minister for Treasury and Resources as shareholder. In accordance with P.73/2010, SoJDC reports to its Shareholder on a quarterly basis with regard to progress and viability. The Minister Treasury and Resources, in turn, updates the States Assembly via briefings, statements and answers to States questions. Regardless of this point, the Minister has on numerous occasions demonstrated and justified to the Assembly that the development of Building 4 will not result in a loss to the Public.
12	In the event that B4 were only to 'break even', it would not deliver sufficient 'profit' to fund its proportion of the proposed public realm (including the underground car park).	The Minister is satisfied that evidence exists to forecast that Building 4 will generate a profit.
13	The Masterplan for the Esplanade Quarter is not viable.	The Minister is not clear on the evidential basis for this statement. The Masterplan is a flexible, living document and will develop and change over time. The DTZ/C&W Red Book Valuation, combined with the costs forecasts provided by SoJDC, suggest that the JIFC would provide the financial wherewithal to complete the current masterplan proposals to lower La Route de la Libération

	Findings	Comments
		and carry out all of the public infrastructure associated with Phase 1 (the JIFC), should this continue to be the States Assembly's desired outcome.
14	Burying the road (La Route de la Libération) is not viable.	The Minister is not clear on the evidential basis for this statement. The Masterplan is a flexible, living document and will develop and change over time. The DTZ/C&W Red Book Valuation, combined with the costs forecasts provided by SoJDC, suggests that the JIFC would provide the financial wherewithal to complete the current masterplan proposals to lower La Route de la Libération and carry out all of the public infrastructure associated with Phase 1 (the JIFC), should this continue to be the States Assembly's desired outcome.
15	The Masterplan for the Esplanade Quarter will need to be re-appraised, and then presented to the States Assembly for debate.	EY advise that a review of the Masterplan be undertaken. This is a matter for the Minister for Environment to consider in conjunction with the Council of Ministers.
16	The key issue of having seamless connectivity between the Esplanade Quarter scheme (in particular to the South of La Route de la Libération) and the town will need to be resolved in a different manner.	EY advise that "an updated review on the Masterplan with more economically deliverable objectives should achieve most of the original aims whilst retaining the prospect for the generation of surpluses". The Masterplan set out 6 main objectives, one of which was the connectivity between the town and the Waterfront. There may well be alternative approaches that can deliver connectivity in a more economic manner. This would need to be assessed as part of any review of the Masterplan that the Minister for Environment may choose to undertake following the publication of the EY report.

RECOMMENDATIONS

	Recommendations	**To**	**Accept/ Reject**	**Comments**	**Target date of action/ completion**
1	An updated viability assessment of B4 must be immediately undertaken by the Minister for Treasury and Resources, taking account of the effect upon profit of any rent free or other tenant incentives both agreed and proposed together with due allowance for all known and planned costs of delivery.	T&R	Accept	This recommendation has already been complied with in a number of ways. SoJDC already provide quarterly updates on viability and progress to the Shareholder in accordance with its MoU and P.73/2010. HSBC have made financing available to SoJDC, based on its own commissioned appraisal of financial viability. The Minister for Treasury and Resources has also commissioned a Red Book Valuation of the entire JIFC development, and Jersey Property Holdings has deducted the total development costs to reach an assessment of the financial viability of each building and the JIFC as a whole, taking into account SoJDC's disposal strategy.	Complete
2	Such a viability assessment must be presented to both the Corporate Services Scrutiny Panel and the States Assembly.	T&R	Reject	The Panel's advisers were supplied with all of the information they requested for the purpose of carrying out their work. They have prepared their report in such a way that the confidentiality of this information has been respected. Their finding is clear that Building 4 should be completed, and that Building 5 should be progressed, assuming a similar level of viability to Building 4. The Minister is prepared to supply the Panel with the report commissioned by him from DTZ/C&W. The detailed findings cannot be presented publicly to the Assembly. The Panel is fully aware of the reasons for this, and the Minister is disappointed that they choose to make a recommendation that is not capable of being implemented.	N/A

	Recommendations	To	Accept/ Reject	Comments	Target date of action/ completion
3	Regardless of the outcome of the fully-disclosed viability assessment for B4, appropriate processes for the re-appraisal of both the full JIFC proposals and the wider Esplanade Quarter Masterplan, as recommended by EY, should be implemented. Such re-appraisal should also take into account development proposed by the private sector along the Esplanade immediately adjoining the JIFC site.	T&R	Reject	The Esplanade Quarter is a 20 year project. SoJDC is developing out the project in a logical, phased manner in response to demand, and in accordance with the directions of the States Assembly. Each element of the phased delivery will naturally take into account a number of factors, including other developments in the locality, as part of the ongoing viability assessment. A full re-appraisal of the viability of the JIFC development and the Masterplan as a whole is not considered to serve any purpose at this stage, and this is not the EY recommendation. EY advise the following – *"An updated review on the Masterplan with more economically deliverable objectives should achieve most of the original aims whilst retaining the prospect for the generation of surpluses which SoJ could apply to capital projects elsewhere on the Island".* EY's main concern appears to concern the *"proposals to sink the road beneath the development which we consider to be commercially unrealistic and arguably a burden upon the whole project"*. This is undoubtedly an expensive element of the Masterplan, which would result in the States, as shareholder, not receiving any capital receipts from the development until around 2035. A review of the Masterplan could assess the alternative approaches to achieving the connectivity which may be deliverable in a more cost-effective manner, thereby enabling States' access to the development receipts as early as 2020, which	N/A

	Recommendations	To	Accept/ Reject	Comments	Target date of action/ completion
				could then be put towards alternative uses, such as the regeneration of St. Helier. Re-appraisal of the JIFC development as a whole is not considered necessary or useful by the Minister at this time due to the prudent, staged approach being adopted. A review of the Masterplan is a matter for the Minister for Environment in conjunction with the Council of Ministers.	

CONCLUSION

The Minister is fully supportive of the Scrutiny function. It is therefore uncomfortable for him to be unable to agree with the majority of the Panel's findings and recommendations. This response should be contrasted with the appended response to the findings of the Panel's expert advisers, EY. Their findings are clearly evidenced and are accepted. It is the conclusions drawn by the Panel from that work that the Minister is unable to clearly understand.

The JIFC development has been subject to an unprecedented level of public scrutiny. The Minister would welcome the opportunity to work collaboratively with the Panel on an approach which would alleviate the concerns expressed by a section of States Members and the Public in general. The Minister is entirely satisfied that he has sufficient evidence that the JIFC development is of direct financial benefit to the taxpayer and the Public. The wider economic benefits to the Island are incalculable, and the risks to the Island's most productive industries of not proceeding are unthinkable. If the Panel's remaining work on this subject serve to better inform the Assembly and the Public that the development is not only desirable but essential, then the Minister is pleased to contribute to that process.

APPENDIX

EY REPORT EXECUTIVE SUMMARY

	Findings	Comments
1	The masterplan for the Esplanade Quarter was adopted in 2008 at a time when the commercial outlook and market expectations in Jersey were very different than they are today.	Agreed; however, it should be noted that Jersey's economy is improving, and having cumulatively lost 19% on its GVA levels since 2007, last year (2014) saw a 5% increase. There is significant pent-up demand for new Grade A office accommodation in St. Helier, having had very little new space delivered during the recession. There is currently c. 300,000 sq. ft. Net Internal Area (NIA) of new build office under construction. The level of pre-lets and construction which has occurred since April 2014 exceeds pre-recession activity. Furthermore, the residential property market is also showing marked improvement, with the number of property transactions back to pre-recession levels, and the average value of property exceeding the 2008 high for the first time (reported in Q3 2015 House Price Index).
2	SoJDC are about to embark upon a 'phased' development of Phase 1 of the Quarter, namely by the construction of Building 4 providing 68,173 sq. ft. of Grade A office accommodation.	Agreed. The Esplanade Quarter Masterplan provides for a mixed-use development of 1.1 million sq. ft. of NIA. The primary uses include office (620,000 sq. ft.), residential (290,000 sq. ft.), and visitor accommodation (130,000 sq. ft.). Phase 1 will deliver up to 470,000 sq. ft. of office accommodation in 6 standalone buildings on the site of the existing Esplanade Surface Car Park (in accordance with the revised Masterplan). SoJDC is carrying out the development on a building-by-building basis in response to known demand, and is only commencing the construction of a building once a significant level of pre-let is achieved.
3	We are instructed by the Scrutiny Panel to provide advice upon the viability of Building 4 and to comment upon the implications which our conclusions may have for the remainder of JIFC and also for the Esplanade Quarter proposals as a whole.	Noted. [Please note my reading of EY's Statement of Work (Appendix A of its report) did not limit the instruction to the viability of No. 4 JIFC and this may have evolved during their appointment.]

	Findings	Comments
4	As part of our work, we have received information from SoJDC which is commercially sensitive and necessarily confidential. The Scrutiny Panel has agreed that, in order that we may receive this important information, we may enter a Non-Disclosure Agreement with SoJDC. This was exchanged on 15 July 2015.	Agreed.
5	Consequently our analysis contained in this report, whilst informed by this confidential data, does not disclose any of this confidential information. It is important to note that this confidential data alone has not driven our conclusions which are also based upon our findings in relation to the office market in Jersey.	Noted.
6	For example, we refer in our analysis to tenant incentives which could be agreed to secure tenants. In reality our analysis only allows for rent free periods which in our view would be representative of the market. Therefore, should it be necessary to correlate our analysis with the actual situation, it will be necessary to obtain this direct from SoJDC.	Noted. [We note that the report sets out, on pages 24 and 25, that the rent-free element of the incentives provided on 37 Esplanade ranged from 9 to 15 months. On page 47, EY details that Rent-Free of 18 to 24 months has been allowed for within its valuation of No. 4 JIFC.] SoJDC has publicly disclosed that it will hold these office buildings for 3 years after the completion of the build. This will ensure that all rent-free periods are wound out, and that SoJDC benefits from any uplifts at first review. There is nothing uncommon about this strategy – Dandara has now held 37 Esplanade for at least 24 months since first occupation. SoJDC will have to bear the interest costs of holding the building for 3 years; however, the rental stream that will flow on expiry of the rent-free periods will exceed the cumulative hold cost and any other incentives that JDC may have given.

	Findings	Comments
7	For the avoidance of doubt, our analysis of viability does not represent the actual out-turn as will be experienced by SoJDC in terms of actual profit. This can only be achieved by a direct correlation with the data held by SoJDC which is necessarily confidential from the public domain.	Noted. However, EY has reflected its position in the full knowledge of this information which it received having signed a suitably enforceable Non-Disclosure Agreement.
8	We detail below and in the body of our report the outcome of our analysis together with our observations and conclusions. It is important to appreciate that we have not carried out an audit of the actual costs, both incurred and proposed, for the scheme.	Noted (statement of fact – no further comments).
9	Given that there remain costs which are material to the viability of the scheme which are either unresolved or confidential in nature, we would expect that SoJ, as sole shareholder of SoJDC, ensure that they are fully briefed upon the potential impact of these matters through their normal channels of communication.	Noted. In accordance with SoJDC's Memorandum of Understanding with its Shareholder, the Minister for Treasury and Resources, and P.73/2010, SoJDC provides quarterly updates to the Minister, and covers both progress and viability of the Company's projects.
10	We assess the gross development value of Building 4, net of purchaser costs (i.e. reflecting the anticipated sale price), assuming a stabilised rental profile (i.e. all rent frees 'washed' through) of £32.65m. In other words this is our view of the potential price at which the building could be sold once complete and fully income producing.	Noted (statement of fact – no further comments).

	Findings	Comments
11	This assumes full rent received of £2.428m per annum, i.e. £34 per sq. ft., and an investment yield of 7%.	Noted. SoJDC's position is that the value of the building should be based on an investment yield of 6.5%. This yield is supported by BNP Paribas Real Estate and DTZ.
12	Assuming the fourth and fifth floors are pre-let with the equivalent of 24 months rent free with the remaining floors leasing up between 6 to 18 months post practical completion, all with 18 month rent free agreements, we calculate that the development will return a profit of £3.04m. This represents a return of 12.04% on costs incurred, and specifically assumes that the site is contributed at zero cost.	Noted. SoJDC's position is that there will be no letting void on Practical Completion. Based on SoJDC's projected figures for rent and yield, it considers that No. 4 JIFC will generate a net return (profit and land value combined) of £7.5 million.
13	Our analysis provides sensitivities to this outcome varying the investment yield and the leasing voids.	Noted.
14	You will note that we have also provided an analysis of the potential profit based upon the views which have been expressed by SoJDC, namely a lower yield of 6.5% and assuming the building is fully let on completion.	Noted. These views on yield are not only those of SoJDC; BNP Paribas Real Estate (SoJDC's letting agent) and DTZ (on behalf of HSBC) also conclude that a yield of 6.5% should be achieved.
15	Although we do not agree with these assumptions, they do demonstrate that if the building was fully let prior to completion (with tenant incentives of 18 – 24 months) and the investment is then saleable at a yield of 6.5%, an acceptable profit including site contribution would be delivered.	Noted. The most significant variable in the valuation of an office building is yield. SoJDC and its letting agent, BNP Paribas Real Estate, conclude that the standard of design and specification coupled with 'blue chip' tenants, these buildings should deliver a yield of 6.5%. A yield of 6.5% has also been concluded by DTZ in its independent Red Book Valuation for the Funder of No. 4 JIFC, HSBC. A half a percent shift in yield would have the effect of adding around £3 million to the value of No. 4 JIFC.

	Findings	Comments
16	This demonstrates the upside potential as suggested by SoJDC although in our view it does not fully reflect the likely outcome based upon the evidence of current market conditions.	It is the view of SoJDC and its letting agent BNP Paribas Real Estate that this high-quality and unique development will be an attractive investment proposition and that the Jersey market is improving, with more inquiries from investors. The same level of yield was also adopted completely independently by DTZ in its valuation for HSBC.
17	That said, we also consider that this weak profit performance is not a reason alone to not proceed with the development.	Noted and supported.
18	We believe it appropriate to embark upon this first step, largely as a catalyst to the commencement of this regeneration project which is so important to Jersey.	Noted and supported.
19	This presupposes that SoJDC can demonstrate that the scheme will deliver at least a profit or no cost to SoJ. This will require their disclosure to their shareholder of an updated viability review focused on Phase 1A – Building 4 above, taking account of the effect upon profit of any rent free or equivalent tenant incentives, both agreed and proposed together with due allowance for all known and planned costs of delivery.	Noted. SoJDC has publicly disclosed that it will hold these office buildings for 3 years after the completion of the build. This will ensure that all rent-free periods are wound out and that SoJDC benefits from any uplifts at first review. There is nothing uncommon about this strategy – Dandara has now held 37 Esplanade for at least 24 months since first occupation. SoJDC will have to bear the interest costs of holding the building for 3 years; however, the rental stream that will flow on expiry of the rent-free periods will exceed the cumulative hold cost and any other incentives that JDC may have given. The SoJDC projected £7.5 million return, therefore includes for all tenant incentives.
20	In particular at the time of this report being finalised SoJDC had begun site excavation works. It has become clear that additional and unbudgeted costs are being incurred to decontaminate the site. Our analysis makes no allowance for environmental issues. It follows that, once established,	The EY report included a contingency of 2.5% on construction costs. The EY report also included a greater finance cost and greater marketing costs than incurred by SoJDC. Following cost confirmation to date on the excavation works and decontamination processes, SoJDC's cost projections are that the additional costs associated with dealing with the legacy site contamination will be contained within the EY total cost allowances with no further impact on the EY profit level.

	Findings	Comments
	this will further reduce the profit from the scheme below that which we have indicated above and detailed in our analysis which follows.	
21	A contingency allowance of 2.5% is included in our appraisal but we believe that this should not be absorbed in its entirety for the purposes of allowing for the cost of decontamination given that these costs, whilst unbudgeted, are now partially known.	SoJDC has entered into a lump sum JCT Design and Build construction contract on a fully designed and specified scheme with <1% provisional sums. Any call on the residual contingency is likely to be very minimal, and it is therefore absolutely appropriate to allocate this contingency to the unknown costs of dealing with the legacy contamination.
22	We also believe that it is reasonable to plan for the development of Building 5 to follow as this will complete the frontage to Castle Street.	Noted and supported.
23	However we would strongly advise that a review of both the JIFC proposals and the wider Esplanade Quarter masterplan be undertaken. This must not be at the cost of the current phase but rather to achieve a balanced and commercially based review of the wider scheme.	The JIFC is being undertaken on a building-by-building basis in response to known demand. This significantly reduces delivery risk and ensures the construction work is only progressed if a particular building is viable. There is significant pent-up demand for new Grade A office accommodation in St. Helier, having had very little new space delivered during the recession. JDC is in contact with 20 prospective tenants with a total space requirement of 325,000 sq. ft. Indeed, since starting construction, JDC has received direct enquiries from 6 new prospective tenants. The Minister for Treasury and Resources would not wish for a review of the Masterplan to impact the delivery of Phase 1 of the Esplanade Quarter (namely the JIFC), and should a third or indeed a fourth office building be proven to be financially viable, the Minister would support SoJDC in its progression. Whilst the Minister for Treasury and Resources does not disagree with the recommendation, any review of the Esplanade Quarter Masterplan is a matter for the Minister for Environment in conjunction with the Council of Ministers.

	Findings	Comments
24	In addition, if the cost of site decontamination proves to be a disproportionate cost to developing the wider scheme, then the alternative of capping the site and developing ground and above should be explored as a more realistic and cost effective solution.	The costs of remediating the site and dealing with the legacy contamination issue will be known shortly, and SoJDC has confirmed that based on known and projected figures to date, these costs will be contained with the total cost figures used by EY in assessing the viability of No. 4 JIFC.
25	There are currently proposals to sink the road beneath the development which we consider to be commercially unrealistic and arguably a burden upon the whole project. The associated public realm, including the creation of landscaped amenity areas, should also be considered in the context of a revised masterplan of the wider scheme.	Masterplans are flexible, living documents and will no doubt develop and change over time (particularly as it is predicated that the Esplanade Quarter will take around 20 years to deliver). The DTZ/C&W Red Book Valuation, combined with the costs forecasts provided by SoJDC, suggests that the JIFC would provide the financial wherewithal to complete the current masterplan proposals to lower La Route de la Libération and carry out all of the public infrastructure associated with Phase 1 (the JIFC), should this continue to be the States Assembly's desired outcome. That is not to say that alternatives could not be assessed; however, this would be a matter for the Minister for Environment in conjunction with the Council of Ministers.
26	An updated review of the masterplan with more economically deliverable objectives should achieve most of the original aims whilst retaining the prospect for the generation of surpluses which the SoJ could apply to capital projects elsewhere on the Island. A key to this will be releasing land for residential development, probably to the south side of La Route de la Liberation, much earlier than will be currently possible and to achieve the linkage of this to the JIFC/car park site by other means than the very costly lowering of the road.	[Agreed/Noted]. A review of the Masterplan could assess the alternative approaches to achieving the linkage/connectivity which could be delivered in a more cost-effective manner, thereby enabling States' access to the development receipts as early as 2020. These receipts could then be put towards other regeneration projects in St. Helier and other States capital projects. A review of the Masterplan is a matter for the Minister for Environment in conjunction with the Council of Ministers.