Jersey Finance

Delivering Insight • Driving Innovation

14 June 2016

Deputy J Le Fondré
Chairman, Corporate Services Scrutiny Panel
Scrutiny Office
States Greffe
Morier House
St Helier
JE1 1DD

Dear Deputy Le Fondré

Corporate Services Scrutiny Panel: Jersey International Finance Centre Review

Thank you for your letter dated 26 May 2016 and for providing the opportunity for Jersey Finance Limited ('JFL' or 'we' as appropriate) to further comment on the important areas under review.

I have sought below to provide an update on performance of the finance sector since our previous submission and then specifically addressed your points of interest, namely "changes to the external market" and "local demand v' s supply".

For the avoidance of doubt, we are agreeable to this submission being made public if it is considered appropriate.

Introduction

In our previous submission, we made reference to the 2007 McKinsey report on sustaining New York's pre-eminence as a global financial services centre, commissioned jointly by the then-Mayor of New York Michael Bloomberg and Sen. Charles Schumer of New York. The McKinsey report surveyed CEOs and other senior executives in order to gain insight into the relative importance of 18 key attributes that give one International Finance Centre (IFC) a competitive edge over another.

Of the top four factors deemed to be of high importance, government and regulator responsiveness to business needs tied for third with the attractiveness of the regulatory environment.

Since our original submission in March of last year, we have continued to hear a consistent message from our membership that a larger stock of Grade A office accommodation in Jersey is not a luxury in a globally competitive environment, but a palpable business need if the Island is to retain and continue to grow its stable of global financial services players. Without sufficient Grade A office accommodation, Jersey will risk a reversal of its recent inward investment successes. Indeed, the scarcity of modern, spacious, top quality office space could become a driving factor in existing businesses consolidating operations and relocating off-Island. This is a risk to the Island that should be avoided at all costs.

Jersey's finance industry continues to experience strong growth in the challenging post-2008 environment, both in terms of profitability and number of people employed. Combined with a strong inward investment pipeline, demand for Grade A office accommodation shows no signs of abating.

Finance industry's growing contribution to Jersey's economy

When our initial comments on JIFC were submitted in March 2015, the most recent figures available from the States of Jersey Statistics Unit showed approximately 12,500 people employed by the finance industry in Jersey. In the year that has passed since our original submission, that figure now stands at some 13,000 people.[1] This represents a growth rate in excess of 3% over a period of 12 months, a remarkable achievement in itself.

In addition to the above, I would highlight that JFL undertakes a twice-yearly 'Employment and Growth Survey' of our member firms, the most recent of which ran during March 2016. Projections provided by a statistically representative sample of our members provide estimates for employment growth that would indicate the industry growing by almost 1,000 net new jobs over the next 5 years. Whilst there is no guarantee this will happen our back testing of these projections has given rise to a reasonable degree of confidence in their reliability. If this growth is achieved, we could see finance industry employment exceeding 14,000 by 2021.

Given this continuing growth in the Island's finance industry headcount, it should come as no surprise that the economic contribution of the finance industry to Jersey has also seen growth. The most recent figures available, for 2014, indicate a total GVA contribution of 44%, up from 42% in 2013. More broadly, this represents over half (51%) of all economic activity in the island (excluding private household rental income).[2] In sum, the 2014 figures represent a 9% year-on-year increase for the finance sector.

This 9% increase in activity, itself a striking marker of the health of the finance industry in the Island, reflects as well the sector's increased profitability. Total finance sector net profits for 2014 stood at £1,470 million, an increase of £290 million or approximately 25%, compared with the 2013 figure referenced in our previous submission. The industry spent £740 million in 2014 on goods and services, including almost £1 million per day in the local economy.[3]

Feedback from JFL membership reinforces the positive story told by these indicators for the most recent years for which statistics are available. Both the positive statistical data and the reinforcing anecdotal evidence reported by the JFL membership should be borne in mind when considering the value that the new JIFC has the potential to deliver to the Island's economy.

Industry trend towards consolidation means rising demand for suitable commercial space

As global financial regulatory standards rise, with Jersey at the lead in many instances, the need for industry expertise to ensure compliance with emergent, complex regulatory demands for compliance and reporting have brought increased pressure to bear upon the industry. Most profoundly affected by the increasingly challenging regulatory burden are smaller firms, who find the scale and scope of regulation to pose real financial challenges in terms of growing staffing and expertise requirements.

Consolidation is often the most efficient and viable response to this demanding new global regulatory environment, whereby larger players with the resources and expertise to allocate to the compliance sphere absorb smaller firms. This trend towards consolidation is unlikely to slacken anytime in the near future.

One needn't look far to see the impact of consolidation on the Island's finance industry. The announcement this month by First Names Group of its acquisition of Nautilus, continued their growth through acquisition and expansion which begun in 2012.

---

[1] States of Jersey Statistics Unit – Labour Market Report December 2015
[2] States of Jersey Statistics Unit – GVA and GDP 2014
[3] States of Jersey Statistics Unit – Survey of Financial Institutions 2014

Elian has also continued to grow its business with the acquisition of SFM Europe in December 2015. Similarly, JTC's acquisitions of Kleinwort Benson's Fund Administration business in July 2015, Herald Trust in 2014, and most recently Signes, a Luxembourg-based *Expert Comptable* in September 2015 and GAM's Cayman fund administration business in January of this year continue the trend towards consolidation.

The market of small Trust and Company Service Providers has been well-served by the commercial property stock in St Helier, but consolidation, as outlined in the examples above, is changing the nature and scale of this demand. Indeed, First Names Group and JTC Group have recently taken Grade A office space at 37 Esplanade and 27 Esplanade respectively as they sought appropriate accommodation after their above mentioned expansion and acquisition.

Simultaneously, banks are looking increasingly to reduce costs and consolidate into single jurisdictions. A move is afoot whereby banks are questioning whether it is necessary to have a presence in all three Crown Dependencies, or whether business needs can be met by one, single hub. For RBC, encouragingly the answer was a resounding vote of confidence for Jersey as their flagship offices near completion on the Esplanade. Coutts came to the same conclusion in bringing its operations in Guernsey and Jersey together here in the Island.

Jersey, notwithstanding these victories, cannot afford to be complacent. ABN AMRO reached a different conclusion than RBC and Coutts last year, and rolled its Jersey private client business into its Guernsey operations. Not all such decisions are within the control of the Island, and many factors will be at play. However, what the Island can do is put itself in the strongest possible position to retain business by continuing to be responsive to industry needs.

Consolidation isn't simply a matter of business decisions taken on a purely financial and organisational basis. Looking down the road, as new international regulatory initiatives for information exchange and transparency gain traction, some IFCs will likely drop from the field in 10 or 20 years' time.

Consolidation won't be a choice but rather a necessity for some firms. It does though constitute a particularly attractive growth opportunity for the Island as such multi-jurisdictional consolidation may bring high value 'head office' roles and staff to Jersey with a corresponding demand for locally qualified personnel.

Jersey needs now to take steps to guarantee that it will be an attractive candidate for both consolidating businesses as well as relocations. Such appeal and commitment to the finance sector will be made most visible through the presence of the Grade A commercial development that is the JIFC.

External economic factors and the impact on Jersey

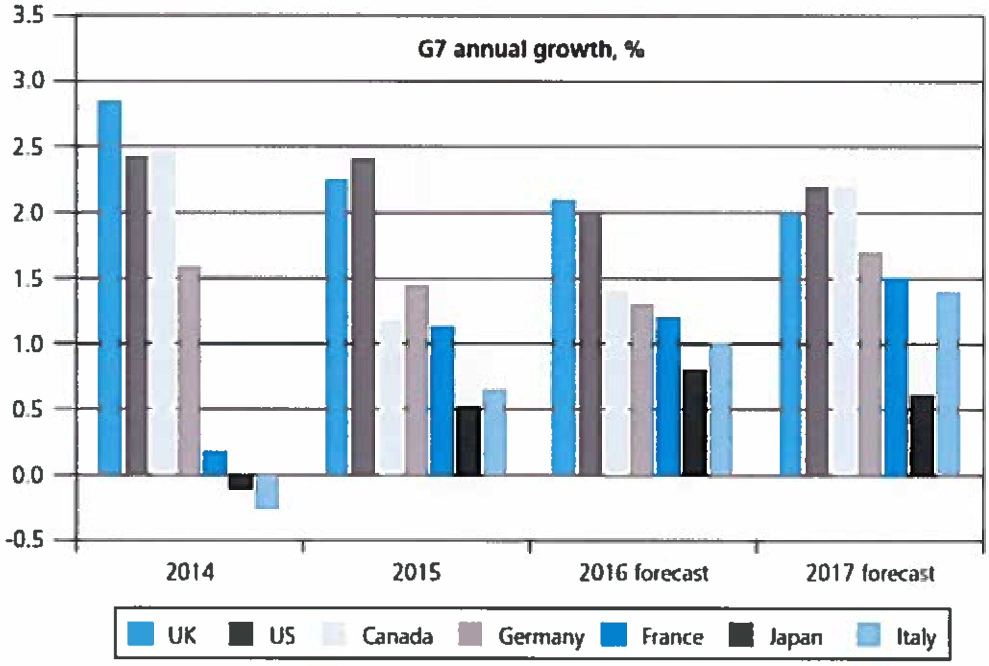
The performance of Jersey's finance industry is inextricably linked with global economic trends and, in particular, that of the UK. This time one year ago, the outlook for the UK - and by extension Jersey - was encouraging, as solid growth was forecast through to 2019. With the benefit of another year's data, those forecasts have been adjusted. Given the major challenges facing not only the UK but Europe as a whole, including the uncertainty brought on by the upcoming referendum on UK membership in the EU and the refugee and migrant crisis affecting Europe and beyond, it is not altogether surprising that forecasts have seen an across-the-board softening. What is surprising, given the scale of the challenges, is that the downward adjustment of forecasts has been slight with prospects softening by a mere 0.2% in the latest Treasury GDP growth forecasts.

Table 1: UK - GDP growth forecast, percentage change from previous year

	2014	2015	2016	2017	2018	2019
March 2015 letter	3.0%	2.4%	2.2%	2.4%	2.3%	2.3%
Latest forecast	2.8%	2.2%	2.0%	2.2%	2.1%	2.1%

Source: HM Treasury Autumn Statement 2014 and HM Treasury Budget 2016

Put into global context, these estimates still place the UK at the top of the league table in terms of G7 growth projections, with sustained predicted growth over the coming three years at or above 2.0%.



Source: Organisation for Economic Co-operation and Development

Jersey's close ties to the UK economy, and in particular the performance of the City of London, means that growth for the UK translates to the strong potential for growth for Jersey. It is imperative that Jersey stands ready to seize upon the opportunities that will come with the solidifying economic UK economic picture.

In our target markets (listed in Table 2, below) growth expectations also remain positive and, with low oil prices expected to persist at least through 2016, net importers such as China and India have an excellent opportunity to flourish. Such opportunities may well, for understandable reasons, come at the expense of declining markets such as Russia.

Table 2: JFL target markets - GDP growth forecast, percentage change from previous year

	2014	2014 revised	2015	2015 revised	2016	2016 revised	2017	2017 revised
World	2.6%	2.6%	3.0%	2.4%	3.3%	2.4%	3.2%	2.8%
China	7.4%	7.3%	7.1%	6.7%	7.0%	6.7%	6.9%	6.5%
India	5.6%	7.2%	6.4%	7.6%	7.0%	7.6%	7.0%	7.7%
Middle East high income oil exporters	4.7%	3.4%	4.1%	2.9%	4.2%	2.0%	4.3%	2.3%
Nigeria	6.3%	6.3%	5.5%	2.7%	5.8%	0.8%	6.2%	3.5%
Russia	0.7%	0.7%	-2.9%	-3.7%	0.1%	-1.2%	1.1%	1.4%
South Africa	1.4%	1.5%	2.2%	1.3%	2.5%	0.6%	2.7%	1.1%

Source: World Bank Forecast Table and Global Economic Prospects, January 2015 and June 2016

Looked at from a different perspective, even a decline in economic fortunes in other regions may create opportunities for Jersey. Economic uncertainty and political instability can provoke an economic 'flight to quality', away from situations where there may be a lack of confidence in the rule of law and the integrity of financial deposits. Under such circumstances, Jersey has benefited in the past and will continue to benefit thanks to its widely-respected, stable legal system and regulatory framework.

Local demand trends vs supply

The trend towards consolidation of smaller firms into larger Island businesses, discussed above, highlights a key source of local demand for commercial space. Here the goal must be to meet local demand now and going forward in order to keep businesses on-Island and provide them with pathways to growth. JIFC will be a key factor in future growth, as it will represent a granite and steel commitment by the Island to providing the finance sector in Jersey with the facilities and infrastructure to thrive in a world class environment.

Since writing in March of last year, little new development has commenced to add to the Island's commercial space supply:

- Gaspe House at 66 – 72 Esplanade, as previously reported, is nearing completion and will provide a total of 165,000 sq ft, of which 90,000 sq ft has been pre-let by RBC, and a further 10,000 sq ft pre-let by Deloitte;
- Weighbridge House, as previously reported, is nearing completion with a total of 12,000 sq ft of office space across four floors, three of which have been pre-let according to BNP Paribas Real Estate;
- 27/28 Esplanade is being developed by Dandara, with 70,000 sq ft spread over a seven storey office development, 30,000 sq ft of which having been pre-let to the JTC Group;
- 29 – 31 Seaton Place, an infill site, will result in 20,000 sq ft of high specification office space across four floors when completed in summer 2017.

Going forward, the lack of sufficient Grade A office space will pose several risks for the Jersey economy. As businesses consolidate and grow, demand for space will increase, increasing pressure on rents. According to Bilfinger GVA, total office stock in Jersey is in the region of 2.8

million sq ft, with a low vacancy rate below 8%. Much of the space suffers from being second hand, in a secondary location or having a poor specification. Demand within St. Helier's central business district is consistent as businesses look to upgrade to more modern space; annual take up of prime office space in St Helier is in the region of 200,000 sq ft. As a result, there is a consistent upward pressure on rents. In today's fluid financial services climate, it is difficult to predict at what point rents will push business off-Island to consolidate in another jurisdiction.

However, local demand alone will not be enough to sustain the growth needed if Jersey is to remain a leader amongst IFCs. The Island must continue to look outward if it is to prosper; to do so it has no choice but to build the physical infrastructure and amenities of the calibre necessary to compete with other global IFCs. JIFC represents precisely the kind of physical infrastructure that global businesses demand and is an investment in the Island's future prosperity.

Inward investment into Jersey is growing. According to Locate Jersey, some 1,303 jobs have been created by trading inward investment businesses in the period 2008 - 2015. Some 81% of these jobs are locally qualified. The leading developing business sectors include corporate services, Fintech, hedge funds and private equity.

Given the lead time required to develop and complete any major infrastructure project, adopting a 'wait and see' attitude regarding office space demands will inevitably mean that some businesses operating in multiple jurisdictions will relocate away from Jersey. Similarly, internationally mobile businesses and individuals, such as fund managers, may choose to relocate to jurisdictions other than Jersey.

Conclusion

No one is possessed of a crystal ball capable of accurately gauging future demand. Predictions are made somewhat more tentative by virtue of the upcoming UK referendum on Brexit and no doubt some measure of the downward modification of growth estimates is a result of this uncertainty. However, we take comfort in the fact that the downward revision of a mere 0.2% is slight and the headline story is that Jersey continues to see growth, and will do so into the future.

Local demand for high quality, Grade A office space remains strong, and the quantity of new space either planned or nearing completion will not alter the already low vacancy rate. Likewise, Jersey has been fortunate to benefit from the consolidation of multijurisdictional enterprises firms such as RBC and Coutts 'under one roof' in Jersey. At the same time, Jersey has seen ABN AMRO consolidate operations off-island to Guernsey. While there are undeniably many factors at work in such business decisions, the availability of Grade A, modern office space is an important variable in discriminating between competing jurisdictions.

Growth in financial sector jobs from 12,500 to 13,000 is a strong indicator of the health of the industry, as is the dramatic growth in profitability. Combined, these are increasing demand for suitable office accommodation. This demand for office space should not be taken in isolation. Jersey has been fortunate to see continued, steady, and substantial growth in the financial services arena, with that growth feeding back into the Island's economy. As was noted in the McKinsey study prepared for the City of New York, the presence of a robust finance industry with the regulatory and physical infrastructure to sustain it over time exerts a powerful gravitational pull on new entrants.

There has been little new property development since this time last year, and a reaffirmed commitment to JIFC by the States will send a compelling message to the global market that Jersey is making the long-term investment in infrastructure that will serve both the growth of extant business in the Island whilst attracting new, high quality businesses seeking to relocate.

I trust that the above comments are helpful and I should be pleased to elaborate on this submission in person should the Panel deem this to be helpful.

Yours sincerely

Geoff Cook
Chief Executive