Treasury and Exchequer

19-21 Broad Street
St Helier
Jersey
JE2 3RR

17 June 2024

By email

FAO:
Public Accounts Committee (PAC)
c/o States Greffe
Morier House
Halkett Place
St Helier, Jersey CI
JE1 1DD

Dear Deputy Kovacs,

States Annual Report and Accounts 2023

Further to your letter dated 3rd June 2024, please find below the answers for the Department for Treasury and Exchequer to the Public Accounts Committee (PAC) questions as part of its review into the States Annual Report and Accounts for 2023.

Investment Returns

1. What were the investment returns for 2023?

A summary of investment returns is included in the ARA on Page 79. The investment return for the Common Investment Fund, through which the individual Funds of the States are invested was 10.7%.

2. How does the three-year performance average compare to the annual performance in 2023?

The three-year average performance is lower than the 2023 performance at 4.5%. This reflects market volatility over the period, in particular a market fall seen across a broad range of assets seen in 2022 and subsequent recovery 2023.

19-21 Broad Street
St Helier
Jersey
JE2 3RR

3. Despite the positive returns, how did the investment performance in 2023 compare to the benchmark?

Narrative covering the performance against benchmark is included in the Summary of CIF performance on page 79 of the ARA.

Fund	Investment Valuation £m	2023 Actual net performance	2023 Benchmark performance
Social Security (Reserve) Fund	2,179m	12.0%	10.5%
Strategic Reserve Fund	1,092m	10.0%	8.8%

As illustrated above for the two largest Funds, performance over 2023 was in excess of benchmark.

4. In what ways did the exceptional volatility influence investment strategy and decision-making?

Investment strategy is under frequent review by the Treasury Advisory Panel (TAP) their decision making process was unchanged over the period. Long term strategic allocations are designed to deliver returns across a range of economic conditions, and over a full market cycle. As a long-term investor GoJ is able to look through periods of short-term volatility, as seen in 2022, to generate superior medium to long-term returns.

During the year, TAP identified that one asset class, Absolute Return Bonds, had seen changes to the market environment in which it operates and the pool was restructured to better capture an improved risk adjusted return in the expected prevailing conditions.

5. What measures, if any, were taken to mitigate risks associated with the exceptional volatility?

Risk and volatility are considered carefully in portfolio construction, where steps are taken to control the level of risk to which a fund is exposed. TAP run scenario planning sessions to stress test portfolios and during recent history assets behaved broadly in line with expectations given market conditions. This is not to say that tactical decisions were not taken to react to volatility, but that these decisions were taken by underlying investment managers, who have the expertise to determine the active positions which best serve to maximise value given market conditions and within mandate limits agreed on their appointment.

TAP frequently review manager performance and outlook in relation to market conditions and will take action to ensure the asset mix remains appropriate. During the year the environment in which fixed income assets operate was deemed to have changed.
TAP concluded there was a greater risk looking forward of unanticipated movements in inflation, likely increasing disparity of credit characteristics across geographic regions and sectors.

Historically CIF fixed income exposure was predominantly focused on operation in a low-rate environment and mitigating the risk to capital values which could stem from rates rising from a low nominal floor (bonds traditionally fall in value as rates rise). Given expectations and ongoing unpredictability in rates and inflation, the fixed income portfolio was restructured. The absolute return bond pool was replaced with the return seeking credit pool, intended to give greater flexibility to reposition quickly in response to uncertainty but also better capture returns from higher rates and benefit from the broader global opportunity set.

19-21 Broad Street
St Helier
Jersey
JE2 3RR

6. How do the investment returns in 2023 align with long-term investment goals or objectives?

Fund	Investment Valuation £m	2023 Actual net performance	Target	Target return For 2023
Social Security (Reserve) Fund	2,179m	12.0%	RPI + 3%	7.5%
Strategic Reserve Fund	1,092m	10.0%	RPI + 2%	6.5%

As detailed in the table above, investment returns over 2023 exceeded Fund target returns, designed to meet their long-term objectives.

7. What lessons, if any, were learned from navigating the exceptional volatility in 2023?

Portfolios constructed with perfect hindsight will always be optimised for the conditions experienced, our portfolios are however carefully constructed to maximise Fund chances of meeting their long-term objectives across a wide range of market environments.

Scenario planning and in-depth analysis performed in the setting of strategy and selection of managers has been key to the ongoing success of the portfolio. Although volatility is expected to continue, performance over the period has validated the approach adopted. Through careful portfolio construction, wide diversification, and careful active management TAP remain confident that the portfolio is well positioned to meet our long-term investment objectives for the public of the Island.

Investments and ALO's

In responding to these questions, it must be borne in the mind that the three States-owned entities (SOEs), consolidated within the States of Jersey's annual accounts, each has its own Board of Directors that are responsible for the management of their company assets, investment and debt strategy. That said, the Minister for Treasury & Resources does have oversight and a measure of control in accordance with the Memoranda of Understanding and other governance arrangements, including agreement of Strategic Plans.

1. What types of investments and loans are held by the ALO's (Andium, JDC, and Ports)?

By "investments" this is taken to refer to assets not held by the SOE as part of their raison d'être, e.g. Andium's social housing stock, and "loans are held" is considered to reference loans assumed by the SOE and owed to third parties.

Andium

- Andium has some commercial and residential properties classified as "income properties" but they represent less than 2% of the Andium assets.
- Andium has borrowing from the Housing Development Fund ("HDF") and through its own Revolving Credit Facility ("RCF") with a consortium of banks on competitive commercial terms.

SoJDC

- SoJDC has 3 investment properties, besides its developments, and the investment in a Joint Venture company - the company responsible for the Horizon residential apartments. Full details of these investments are set out in the SoJDC 2023 annual report and accounts.
- SoJDC has bank loans/facilities to fund a construction project and to fund the purchase of the Waterfront Leisure Centre. These facilities are on competitive commercial terms.

19-21 Broad Street
St Helier
Jersey
JE2 3RR

Ports

- Ports has an RCF with a consortium of banks that is being used in the furtherance of its Harbour and Airport master plans. The financial structure and arrangements were approved by the Ports' Board, following receipt of specialist advice.

2. How do the interest rates on loans from Andium, JDC, and Ports compare to previous situations where the States contributed as a guarantor?

These SOEs have not benefitted from loans from the States as guarantor previously, save for Andium's loans from the HDF. What can be said here though is that the SOEs benefit from the fact that they are 100% owned by Government when negotiating terms with banks, in terms of their credit rating.

3. How does the current interest rate situation impact the financial position of the ALO's?

Each SOE has hedging policies in place with a view to managing interest rate risk. Where RCF interest rates are variable there is an inherent risk with movement in rates which the Boards seek to manage.

4. What efforts have been made to explore options for improving the interest rates on loans and investments?

The SOE Boards monitor their interest rate exposure and risks regularly in accordance with their hedging strategies. Other options are considered but there are fundamental risks with renegotiating terms as discussed in point 7 below.

Undeniably higher interest rates, all else being equal are a significant risk to the viability of project financing for all of these 3 SOEs.

5. Are there any strategies being considered to renegotiate loan terms or seek alternative financing options to save money?

The SOE Boards maintain close relationships with local funding banks and regularly discuss available products which may be of benefit to the SOEs as well as maintaining dialogue with other potential lenders, as well as the Treasury.

The SOE Boards also take advice from specialist debt advisors from time to time, as funding needs change, e.g. as developments progress or are given approval to proceed.

6. How might improving the interest rates on loans from Andium, JDC, and Ports contribute to overall financial sustainability?

Reduced interest rates on the SOE's loans will clearly be beneficial for the SOEs' financial position. As the SOEs receive no grants or funding from Government (aside from the HDF), interest rate costs directly impact on their ability to fund future development projects.

7. What potential risks or challenges are associated with renegotiating loan terms or seeking alternative financing options?

There are significant risks and costs associated with renegotiating any existing loans to third party funders. There will be exit/break fees that could be significant, as well as set-up fees for the alternative financing options, both in terms of the bank/lenders' fees in addition to legal and professional fees associated with putting in place the new financing.

19-21 Broad Street
St Helier
Jersey
JE2 3RR

8. How do the current interest rates impact the ability of the ALO's to achieve their financial goals and objectives?

The current interest rate environment and indeed the wider economic climate has placed additional pressure on financial projections, thereby making future SOE project viability very challenging. The interest rate environment not only increases costs for the SOEs, but also restricts what level of mortgage individual purchasers of Andium and SoJDC properties can raise.

Through their hedging arrangements, the SOE Boards endeavour to manage their interest rate risk, as previously mentioned.

Interest rates are of course just one factor, construction cost inflation for example, is arguably having a greater impact on the viability of SOE developments, in common with private sector developments.

9. General question: What new revenue generation and improved investment return initiatives are you considering to further improve performance in these areas?

The SOE Boards are, despite the challenging current economic climate, progressing their development programmes which will in the fullness of time generate revenue and returns. In terms of specifics:

- Ports is growing its marine services business which generates a healthy diversified income stream. The delivery of the Harbour Masterplan however, is less about growing revenue opportunities and more about providing resilience and capacity for Jersey's maritime and supply chain for the next thirty years.

- SoJDC, as part of its developments, has a focus on making areas a more attractive place to visit and live, through "place making", that is in investing appropriately in quality public realm and public infrastructure and targeting ground floor space for commercial businesses.

- Andium continues with the delivery of its ambitious capital programme with a focus, not only on the sites under construction, but the regeneration of existing sites and the sites rezoned in the Bridging Island Plan.

Additional Questions

10. Can you please confirm whether you are providing quarterly reports to Ministers in relation to performance/budgets, and in what format do these briefings take place?

I can confirm that the Minister is provided with quarterly updates on both financial and non-financial performance, and that meetings are scheduled quarterly for my team and I to brief the Minister on these updates.

11. Are there any areas where performance has been affected since the re-prioritisation of the Government Plan?

There are no areas where performance has been significantly affected, but the focus of some teams has changed to reflect the changing priorities of government.

12. Which departments gave briefings to their respective Minister in relation to their performance across 2023? Can the PAC also be provided with links to these briefings in confidence for its own awareness/information?

19-21 Broad Street
St Helier
Jersey
JE2 3RR

The previous Treasury Minister was briefed on the performance of the department throughout the year as part of the quarterly briefing. In addition, the current Minister was also briefed on the wider ARA for 2023, as would be expected.

I trust this provides you with all the information you need but let me know if there is anything additional you require.

Yours sincerely

Richard Bell
Treasurer of the States

Direct dial: 440215
Email: r.bell@gov.je