PoJ1395J

Ports of Jersey Long-term Pricing Framework

Assumptions

Call for Information

Jersey Competition Regulatory Authority

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Contents

1. Overview

1.1 Ports of Jersey Limited (**PoJL**) is the company that owns and operates the airport, harbours and marinas in Jersey. It is the only licensed port operator for Jersey.

1.2 The Channel Islands Competition and Regulatory Authorities (**CICRA**) is the economic regulator with specific responsibilities in respect of the oversight of PoJL, and is seeking the views of interested parties to inform the development of a long-term pricing framework for PoJL.

1.3 CICRA is introducing such a pricing framework to incentivise PoJL to act in a manner that protects and furthers the interests of ports users in the short and long term.

1.4 This Call for Information marks the public start of the process to introduce that pricing framework. It seeks the views of interested parties about the assumptions proposed by PoJL that underlie its business plan. CICRA will need to come to a decision on those assumptions and the views of informed stakeholders are key to its considerations. A later Call for Information will seek views on the pricing framework which is to be derived from these assumptions.

1.5 This document presents the submission made to CICRA by PoJL and requests comments on that submission. The full text of PoJL's submission is at Annex A. CICRA welcomes responses from all interested parties.

2. Introduction

2.0 Ports of Jersey Limited (**PoJL**) is the company which owns and operates the airport, harbours and marinas in Jersey. PoJL is the only licensed[1] port operator for Jersey, providing commercial port operations and services to a diverse range of customers.

2.1 CICRA (the Channel Islands Competition and Regulatory Authorities) is the economic regulator with specific responsibility in respect of the oversight of PoJL. The duties of CICRA are stated in the Air and Sea Ports (Incorporation) (Jersey) Law 2015 (the **Law**) and are set out in full in Appendix 1. In summary, in addition to licensing port operators, CICRA is responsible for regulating so as best to:

a) protect and further the interests of ports users in the short and long term;
b) ensure that all reasonable demands for port operations can be satisfied;
c) ensure that port operations are provided efficiently and effectively; and
d) ensure that PoJL (as a licensed port operator) has sufficient financial resources.

2.2 In discharging its duties as economic regulator, CICRA places particular emphasis on the oversight of those services provided by PoJL of which PoJL is the dominant supplier[2].

2.3 A CICRA priority is to develop and implement a pricing framework which ensures that charges levied by PoJL, for services where it has been found to be dominant, are reasonable, reflect a fair sharing of risk and incentives between PoJL and ports users, and provide sufficient financial resources to allow for the provision of port operations in both the short and long term.

2.4 CICRA is adopting a proportionate and pragmatic approach to the development and implementation of the pricing framework, relying whenever possible on the information already used by PoJL, subject to an ongoing assessment of the effectiveness of this approach. This is appropriate because, relative to many other economies in which economic regulation occurs, Jersey's is small. The complications and therefore costs inherent in adopting a more intrusive regulatory approach, for example requiring the development of specific regulatory models, imposes costs that can be high relative to the benefits as an approach in Jersey.

2.5 This Call for Information marks the public start of a process to develop and implement a long-term pricing framework. It focusses on the submission made by PoJL, in which PoJL details the assumptions underlying its business plan, on which the pricing framework will be based. The Call for Information seeks input from all interested parties, who are requested to give their assessment of how appropriate PoJL's assumptions are as a basis for PoJL's business plan and the long-term pricing framework.

2.6 CICRA will use the responses to this consultation, together with supporting engagement and further consultation, to inform its thinking and support the development and implementation of an appropriate pricing framework which balances the needs of all stakeholders.

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[1] *https://www.cicra.gg/media/2989/ports-of-jersey-limited-licence.pdf*
[2] *CICRA 16/41: Ports of Jersey – Assessment of Market Power. See also Appendix 1.*

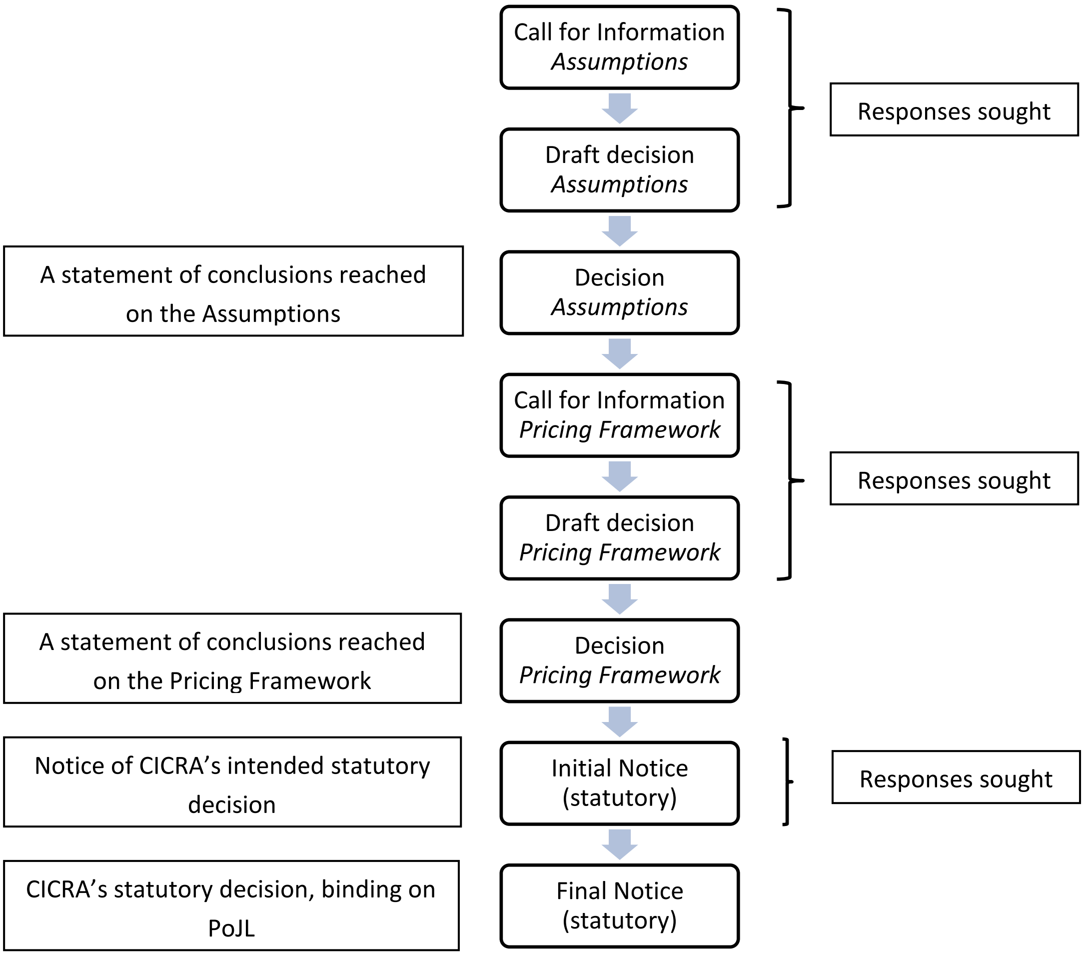
3. Process for setting a long-term pricing framework

3.1 This process for setting a long-term pricing framework has three primary stages:

a) Pre-statutory assumptions stage
b) Pre-statutory price framework stage
c) Statutory stage

3.2 The intention behind the three stages is to ensure that interested parties have an opportunity to comment separately on PoJL's assumptions (the Assumptions stage) and the actual requirements derived from the assumptions (the Pricing Framework stage) before the final Statutory stage that will bring the framework into effect.

3.3 CICRA will follow the process set out below, which is based on its standard Regulatory Consultation Process[3].



[3] *CICRA 18/29*

4. Structure of this Call for Information

4.1 This Call for Information presents the submission made by PoJL in which it sets out the assumptions that underlie its business plan. CICRA will need to come to a decision on those assumptions and the views of informed stakeholders are key to its considerations. It forms the first part of the process outlined in Section 3 above.

4.2 When responses have been received and considered, CICRA will issue a draft decision for further comment.

4.3 PoJL's summary of each of its assumptions and associated justifications is presented in Section 5, together with a question or questions to which CICRA is seeking responses.

4.4 Details on how to respond to the consultation can be found in Section 6, and a summary of next steps is at Section 7.

4.5 The legal framework, on which CICRA's determination of a pricing framework is based, is at Appendix 1.

4.6 The text of PoJL's submission is reproduced in full at Annex A, in order to allow interested parties to review PoJL's proposed assumptions and its justification for each one. Readers of this document may wish to read PoJL's submission before proceeding further.

5. Assumptions contained in Ports of Jersey Limited's Submission

5.1 PoJL's submission is provided in full at Annex A. Set out below is the summary of its assumptions together with a high level justification for each assumption as provided by PoJL. After each assumption, CICRA poses a question or questions in bold, to which responses are sought.

5.2 *Starting Point*

Category	*Assumption*	*Justification*
Starting Point	*Long term foundation and business philosophy are established with the Case for Incorporation documentation and the Air & Sea Ports Incorporation (Jersey)*	*Our base assumptions are borne from the Case for Incorporation and the Air and Sea Ports Incorporation (Jersey) Law. The information contained in these documents formed the basis upon which States of Jersey voted in favour of incorporating PoJL. The long term assumptions established for the modelling of the business remain true, and are reviewed annually through our Strategic Business Plan process.*

Further details can be found on page 9 of Annex A

Question 1: Do you agree with PoJL's proposal that the Case for Incorporation and the Air & Sea Ports Incorporation (Jersey) Law provide an appropriate starting point for the assumptions to be used for a long-term pricing framework? If not, what alternative(s) should be considered, and why?

'Business Planning and Forecasting Assumptions'

5.3 Paragraphs 5.4 and 5.5 contain assumptions proposed by PoJL in its submission as 'Business Planning and Forecasting Assumptions'.

5.4 *General Inflation*

Category	*Assumption*	*Justification*
General Inflation	*Modelled at 3% per annum*	*3.3% per annum is the very latest view from SoJ Fiscal Policy Panel on long term inflation.*

Further details can be found on page 10 of Annex A.

Question 2: Do you agree with PoJL's proposal that 3% general inflation should be used as an assumption for a long-term pricing framework? If not, what alternative(s) should be considered, and why?

5.5 *Business Volumes*

Category	*Assumption*	*Justification*
Business Volumes	*Long Term business volume growth:* • *Air Passengers: 0.8% per annum long run* • *Sea Passengers: 0.0% per annum long run* • *Freight & Fuel: 0.53% per annum long run*	*Baseline (Case for Incorporation)* *Air passengers this was RDC Aviation and for Marine business this was Fishers Associates, validated through Scrutiny review independently using York Aviation and MDS Transmodal.* *Most recently, Mott MacDonald updated forecasts with the work performed on the Master Plan.*

Further details can be found on pages 10 to 13 of Annex A.

Question 3: Do you agree with PoJL's proposal that long-term growth rates of 0.8% for air passengers, 0.0% for sea passengers and 0.53% for freight and fuel should be used as assumptions for a long-term pricing framework? If not, what alternative(s) should be considered, and why?

'Investment Assumptions'

5.6 Paragraphs 5.7 to 5.9 contain assumptions categorised by PoJL in its submission as 'Investment Assumptions'.

5.7 *Master Plans contained within the LTCP*

Category	*Assumption*	*Justification*
Master Plans Contained within the LTCP	*Airport: £42m for Integrated Terminal and associated regulatory investments* *Harbour: Phase 1 only @ £27m (Please note that further phases are being developed)*	*Airport Master Plan as per Stage 3 design estimates, validated by Corgan* *Harbour Master Plan as per Mott MacDonald plan*

Further details can be found on pages 18 to 22 of Annex A.

Question 4: Do you agree with PoJL's proposal that the amounts assumed by PoJL for the airport and phase 1 of the harbour 'Master Plans' should be used for the long-term pricing framework? If not, what alternative(s) should be considered, and why?

5.8 *Long Term Capital Programme (LTCP)*

Category	Assumption	Justification
Long Term Capital Programme (LTCP)	*£286m (uninflated) over 25 years of investments just to keep facilities open to current standards, last reviewed June 2018. It is the LTCP that is required from core business revenues.*	*Originally built from Case for Incorporation, validated by Capita Symonds and York Aviation, updated for current position and forecast.*

Further details can be found on pages 14 to 17 of Annex A.

Question 5: The amounts noted in paragraph 5.7 above are included in the £286m for the LTCP. In addition to specific comments in relation to the 'Master Plans', do you agree with PoJL's proposal that £286m (uninflated) of investment in the next 25 years across the facilities operated by PoJL should be used as an assumption for the long-term pricing framework? If not, what alternative(s) should be considered, and why?

5.9 *Commercial projects*

Category	Assumption	Justification
Commercial Projects	*A portfolio of future investments designed to provide a commercial return.*	*As per 2018 Strategic Business Plan (SBP), last reviewed Sep 2018. Updated for live and forecasted commercial projects.*

PoJL proposes that Commercial Projects already completed will generate £11.3m of 'net revenue' between 2018 and 2022, and a further £11.3m between 2023 and 2027. Other projected cash flows related to projects at different stages of development are also presented by PoJL.

Further details can be found on pages 22 to 24 of Annex A.

Question 6: Do you agree with PoJL's proposal that the 'commercial projects' and associated forecasted cash flows should be used as assumptions for the long-term pricing framework development? If not, what alternative(s) should be considered, and why?

'Debt Assumptions'

5.10 Paragraphs 5.11 to 5.13 contain assumptions categorised by PoJL in its submission as 'Debt Assumptions'.

5.11 *Net Debt on Core Activities*

Category	*Assumption*	*Justification*
Net Debt on Core Activities	*Limit set to 2.5-3.0x EBITDA, or currently £40m, until a regulatory long term price mechanism is established and proven.*	*We judge that 2.5-3.0x EBITDA is prudent for an early stage infrastructure business such as PoJL. Credit rating agencies would see this at the lower end of the Investment Grade spectrum for all companies.*

Further details can be found on pages 25 to 28 of Annex A.

Question 7: Do you agree with PoJL's proposal that it should use a limit of 2.5-3.0x EBITDA[4] for net debt on its core activities as an assumption for the long-term pricing framework? If not, what alternative(s) should be considered, and why?

5.12 *Net debt on Commercial Projects*

Category	*Assumption*	*Justification*
Net debt on Commercial Projects	*As available from institutions and partners on a project specific basis.*	*Debt may be raised solely against project assets but is usually more costly than Company debt and needs to be of a size to warrant the arrangement costs and issues.*

Further details can be found on pages 25 to 28 of Annex A.

Question 8: Do you agree with PoJL's proposal that it should use a net cost of debt on commercial projects based on the terms that may be available from institutions and partners on a project-specific basis as an assumption for the long-term pricing framework? If not, what alternative(s) should be considered, and why?

[4] *Earnings before Interest, Tax, Depreciation and Amortisation. EBITDA is a way of quantifying the profitability of a business excluding financing activities.*

5.13 *Cost of Debt*

Category	Assumption	Justification
Cost of Debt	*5% Long Term, 3% Medium Term*	*Historic interest returns to investors has been 3%, combined with the Bank of England's target inflation rate of 2.5%, it would equate to a long run interest rate expectation of 5.5%.*

Further details can be found on pages 28 to 29 of Annex A.

Question 9: Do you agree with PoJL's proposal to use a cost of debt of 3% in the medium term and 5% in the long term as an assumption for the long-term pricing framework? If not, what alternative(s) should be considered, and why?

'Cost and Cost Pressures Assumptions'

5.14 Paragraphs 5.15 to 5.17 contain assumptions categorised by PoJL in its submission as 'Cost and Cost Pressures Assumptions'.

5.15 *Operating Cost Efficiency*

Category	Assumption	Justification
Operating Cost Efficiency	*A target to reduce the cost base by 0.2% per annum in real terms against Jersey's general and activity specific inflation levels.*	*PoJL is a highly regulated business, whereby many areas of fixed costs (i.e. volume independent) are determined by international compliance standards. Detailed analysis shows the extent to which the remainder is variable. We have high influence over 10% of total opex and moderate influence over 17%, leading to a target to reduce these costs by 1% pa and 0.5% pa respectively in real terms.*

Further details can be found on pages 29 to 35 of Annex A.

Question 10: Do you agree with PoJL's proposal that it should use an efficiency target of 0.2% (in real terms)[5] operating cost reduction for the long-term pricing framework? If not, what alternative(s) should be considered, and why?

[5] *'real terms' is in contrast to a value which includes inflation.*

5.16 *Depreciation of Fixed Assets*

Category	*Assumption*	*Justification*
Depreciation of Fixed Assets	*Determined by the 'Jersey Financial Reporting Manual' accounting standard as in the SoJ published accounts.*	*Upon Incorporation, SoJ transferred the assets to PoJL with an assumption that they would be maintained and replaced as required. JFREM uses a Depreciated Replacement Cost (DRC) methodology to ensure replacement value is maintained.*

Further details can be found on pages 35 to 37 of Annex A.

Question 11: Do you agree with PoJL's proposal that it should use a depreciated replacement cost methodology based on the Jersey Financial Reporting Manual (JFREM) for calculating depreciation in business plans on which the long-term pricing framework will be based? If not, what alternative(s) should be considered, and why?

5.17 *Public Service Obligations (PSOs)*

Category	*Assumption*	*Justification*
Public Service Obligations (PSO)	*PoJL will provide identified obligations, such as maintenance of Historic Harbours and provision of Coast Guard Services that would not normally be the responsibility of a commercial business.*	*The PSOs are as specified in the Air and Sea Ports Incorporation Law, and the cost of provision of these is derived from the commercial operations of the business.* *PoJL are compelled in law to provide these services.*

The PSO associated with the airport, the Channel Islands Control Area (**CICA**), provides an important contribution to fixed costs. The PSOs associated with maritime activities are an ongoing cost burden to PoJL.

Further details can be found on pages 37 to 39 of Annex A. Details of the revenues and costs predicted for the CICA have been provided to CICRA by PoJL but have been redacted from Annex A because they are commercially sensitive.

Question 12: Do you agree with PoJL's proposal that it should assume for the long-term pricing framework that its obligation to provide PSOs as currently set out in law and that the associated costs and revenues will continue? If not, what alternative(s) should be considered, and why?

5.18 *Community Support*

Category	*Assumption*	*Justification*
Community Support	*PoJL will continue to support various community activities in the same manner as before Incorporation.*	*PoJL supports key island events (the Boat Show and Air Display), provides support to a variety of Clubs, Societies and Associations, and maintains heritage assets – all of which comes with a cost.*

Further details can be found on pages 39 to 40 of Annex A.

Question 13: Do you agree with PoJL's proposal that it should assume for the long-term pricing framework that it will continue to support community activities in the same manner as before incorporation? If not, what alternative(s) should be considered, and why?

<u>*'Dividend to Shareholder'*</u>

5.19 Paragraph 5.20 contains an assumption categorised as 'Dividend to Shareholder' by PoJL in its submission.

5.20 *Dividend to Shareholder*

Category	*Assumption*	*Justification*
Dividend to Shareholder	*No cash dividends until the company is financially self-sustainable.*	*SoJ does not budget to receive cash dividends from PoJL and similarly is not called upon to invest. We do however provide incremental cash to SoJ via the 20% corporate tax rate on utilities, as well as covering the cost of PSO obligations which in other jurisdictions are funded by the tax payer.*

Further details can be found on pages 40 to 41 of Annex A.

Question 14: Do you agree that PoJL's proposal that no cash dividends will be paid until PoJL is financially self-sustainable is an appropriate assumption for the long-term pricing framework? If not, what alternative(s) should be considered, and why?

'Funding Philosophy'

5.21 Paragraph 5.22 contains an assumption categorised as 'Funding Philosophy' by PoJL in its submission.

5.22 *Funding Philosophy*

Category	*Assumption*	*Justification*
Funding Philosophy	*Funding for the capital investments will come from a combination of cash generation from core operations and commercial projects, as well as debt raised without SoJ guarantee. We envisage a single till for all CICRA economic regulated activities.*	*Over time, we expect airport operations to fund the necessary airport investments, and harbour operations to fund the necessary harbour investments. However, capital projects are 'lumpy' by nature and in any given year airport or harbour investments may be weighted heavier. The Harbour also has to cross-subsidise the Coastguard and Historic Harbours.*

Further details can be found on pages 41 to 43 of Annex A.

Question 15: Do you agree with PoJL's proposal that it should assume for the long-term pricing framework that funding for capital investments will come from a combination of cash generation from core operations and commercial projects, as well as debt raised without States of Jersey guarantees? If not, what alternative(s) should be considered, and why?

Question 16: Do you agree with PoJL's proposal to use a single till[6]? If not, what alternative(s) should be considered and why?

Question 17: Do you agree with PoJL's proposal that it should not explicitly separate harbour operations from airport operations or make any other possible divisions such as separating public service obligations in the context of the long-term pricing framework? If not, what alternative(s) should be considered, and why?

[6] *Single till – all activities (both regulated and non-regulated 'commercial' activities) are taken into consideration when determining the level of charges. Dual till – charges are determined taking into account regulated activities only. An adjusted or hybrid till includes an elements of non-regulated 'commercial' activities when determining the level of charges.*

'Term of Regulatory Period'

5.23 Paragraph 5.24 contains an assumption categorised as 'Term of Regulatory Period' by PoJL in its submission.

5.24 *Period of Pricing Mechanism*

Category	Assumption	Justification
Period of Pricing Mechanism	*PoJL seeks to establish a 10 year regulatory framework, which will encompass major investment in both the Airport and Harbour.*	*Large infrastructure business such a PoJL require a long term approach both to its finances and to physically delivering the range of required investments. A 10 year period would cover significant investment for both the airport and harbour.*

Further details can be found on page 44 of Annex A.

Question 18: Do you agree with PoJL's proposal that a 10 year period for a pricing framework is appropriate? If not, what alternative(s) should be considered, and why?

Completeness and Further Comments

5.25 Interested parties are asked to consider the assumptions provided by PoJL as a whole.

Question 19: Do you consider the range of assumptions covered by PoJL's submission to be complete in the context of setting a long-term pricing framework? If not, which further assumptions should be considered, and why?

Question 20: Do you have any further comments regarding any part of PoJL's submission which may have a bearing on the development of a long-term pricing framework?

6. How to Respond

6.1 Interested parties are invited to submit comments to CICRA in writing or by email on the matters set out in this Call for Information to the following address:

CICRA
2nd Floor, Salisbury House
1-9 Union Street
St Helier
Jersey JE2 3RF
Email: *info@cicra.je*

6.2 All responses should be clearly marked 'POJ1395J – Ports of Jersey Long Term Pricing Framework - Assumptions: Call for Information' and should arrive no later than 5pm on Friday 2 November 2018.

6.3 If for any reason special provisions are required, please contact CICRA by telephone: 01534 514990 or via email: info@cicra.je and arrangements will be made to ensure that your views are recorded and can be taken into consideration.

6.4 In line with CICRA's consultation policy, it intends to make responses to the Call for Information available on its website www.cicra.je. Any material that is confidential should be put in a separate annex and clearly marked as such so that it may be kept confidential. CICRA regrets that it is not in a position to reply individually to responses to this Call for Information.

7. Next Steps

7.1 CICRA will consider the responses it receives to this Call for Information and after its own assessment will issue a Draft Decision on the assumptions PoJL is proposing to use for its business plan. Comments will be sought on the Draft Decision before CICRA issues a Final Decision. The process will then continue as set out in Section 2 above, towards setting a pricing framework.

7.2 While CICRA considers any Final Decision made as part of the pre-statutory process to be the starting point for later parts in the process and as a statement of its current expectations, no Final Decision is binding on CICRA or on PoJL until such time as it has been included in the statutory process of Initial and Final Notice.

Appendix 1 – Legal Framework

The States of Jersey enacted the Air and Sea Ports (Incorporation) (Jersey) Law 2015 (the **Law**) on 2 June 2015. This requires that any person carrying out Port Operations (as defined in Article 2 of the Law) must have a licence issued by the Jersey Competition Regulatory Authority (JCRA) (which is one of the two entities which together form CICRA).

The following extract from the Law shows the duties of the JCRA, in the context of which CICRA will set a pricing framework:

26 Duties of both Minister and JCRA

> *(1) In relation to port operations, the Minister and the JCRA shall each have a primary duty to perform their respective functions under this Law –*
>
> > *(a) so as best to protect and further the interests of users of port operations, in the short and long term, and to do so where appropriate by promoting competition in the provision of port operations; and*
> >
> > *(b) so as best to ensure –*
> >
> > > *(i) that provision is made to satisfy all reasonable demands, both current and prospective, for port operations,Article 27 Air and Sea Ports (Incorporation) (Jersey) Law 2015*
> > >
> > > *(ii) that port operations are provided efficiently and effectively, and*
> > >
> > > *(iii) that a company (in particular including PoJL), to the extent that it is or is to be licensed under this Law, has sufficient financial resources to discharge its liabilities under securities issued by the company to the States.*
>
> *(2) In relation to lifeline services, the Minister and the JCRA shall each have a primary duty to perform their respective functions under this Law so as best to ensure that such services are provided–*
>
> > *(a) efficiently, effectively and without interruption; and*
> >
> > *(b) so far as consistent with sub-paragraph (a), with due regard to –*
> >
> > > *(i) any relevant policies of the States,*
> > >
> > > *(ii) the interests of persons using or likely to use such services, and*
> > >
> > > *(iii) the special needs of persons who are disabled.*
>
> *(3) So far as consistent with paragraphs (1) and (2), the Minister and the JCRA shall each have duties to perform their respective functions under this Law –*
>
> > *(a) so as best to encourage sustainable growth in the economy of Jersey in the medium to long term;*
> >
> > *(b) so as to impose a minimum of restriction on persons engaging in commercial activities;*

(c) with due regard to any relevant policies of the States;

(d) with due regard to preserving and maximizing the benefits of Jersey's resources; and

(e) with due regard to the special needs of persons who are disabled.

CICRA issued a Principal Port Operator's Licence (the Licence) to PoJL on 1 November 2015, licensing it to carry out Port Operations in Jersey (the "Licence"). Article 15(1)(i) of the Law provides that the Competition Authority may impose licence conditions including requirements for "*the levels of prices, premiums and discounts which may be charged or (as the case may be) allowed by a licensee having a dominant position in the conduct of port operations*".

Under Condition 22.2 of the Licence, the JCRA may determine the maximum level of charges that PoJL may apply for Port Operations within a relevant market in which it has been found to be dominant.

Condition 22.2 of the Licence provides that:

The JCRA may determine the maximum level of charges the Licensee may apply for Port Operations within a relevant market in which the Licensee has been found to be dominant. A determination may:

(a) provide for the overall limit to apply to such Port Operations or categories of Port Operations or any combination of Port Operations;

(b) restrict increases in any such charges or to require reductions in them whether by reference to any formula or otherwise; or

(c) provide for different limits to apply in relation to different periods of time falling within the periods to which any determination applies.

In its Final Notice 'Ports of Jersey – Assessment of Market Power' issued in October 2016 (CICRA 16/41), CICRA made determinations as to market definitions and market power regarding a number of markets within which PoJL operates, finding them dominant in five separate markets. Full details of the determinations can be found in the above document. Given that PoJL is dominant in these markets, and under the licence condition noted above, CICRA may impose a pricing framework on PoJL.

The pricing framework which is anticipated to result from this process will not apply either to PoJL's Public Service Obligations (as defined in Article 6 of the Law) or to services which are not Port Operations. The issue by CICRA of a decision regarding the levels of charges by PoJL is considered to be the exercise of a regulatory function under Article 23 of the Law.

This Call for Information constitutes part of a preliminary process which is intended to make the exercise of a regulatory function by CICRA as appropriate as possible by soliciting the views of interested parties in advance of the determination of the content of the Initial Notice required by Article 23(2) of the Law. It does not, however, constitute Initial Notice. The position of CICRA is liable to change until such time as Final Notice of the pricing framework has been given. Any statements or decisions related to this process issued up to that point will not be binding on either CICRA or PoJL.

Annex A – Ports of Jersey Limited’s Submission of its Assumptions

The following is the full text of PoJL’s submission of the assumptions it intends to make in the generation of its long-term pricing framework submission.

PORTS OF JERSEY
YOUR ISLAND GATEWAY

Ports of Jersey

Long Term Capital and Funding Assumptions and Regulatory Principles arising from Incorporation

Submission to the JCRA

September 2018

Long Term Capital and Funding Assumptions and Regulatory Principles from Incorporation

Introduction

Ports of Jersey Limited (PoJL) was incorporated on 1st October 2015 with a primary aim of ensuring long term financial self sustainability to meet the considerable infrastructure investments required to keep the gateways to the island open, safe and secure.

PoJL is a wholly States of Jersey (SoJ) owned entity which was created upon the incorporation of the Airport and Harbour departments in October 2015. Whilst we operate as a limited company, with the governance and decision making of a private company, all of our profits are reinvested into the Island rather than transferred to private investors.

We are a large infrastructure business in the Island, required to make continued investment in our asset base in order to ensure our gateways are open, safe and secure. The funding for these investments is solely generated from our company operations as we do not receive any government or tax payers funding for our capital requirements.

In order to achieve this, we review our long term capital programme, develop master plans to guide investments and continually seek new revenue growth to create the necessary cash to invest in our core infrastructure.

Our positioning in the Island is to continue to develop our facilities, services and products for the benefit of residents, visitors and businesses. This will primarily be achieved through developing our assets and pursuing growth projects.

We ensure our activities are performed with the optimal safety and security standards, which are routinely audited by competent authorities. We continue to improve our operational resilience, which is crucial for the Island's sole gateways to maintain our important connectivity. Finally we must provide essential public services such as support for our Coastguard service and custodianship of the Island's Historic Harbours.

Part 1 of this document sets out our proposals for the long term capital and funding assumptions that we hope will underpin a long term financial framework for PoJL to be developed by CICRA in conjunction with PoJL and other interested stakeholders, further details of these proposals are set out in Appendix A. Part 2 sets out the regulatory principles that we see arising from the Case for Incorporation. As these documents formed the basis for the decision to incorporate PoJL, we believe they provide important guidance, further details of these principles are set out in Appendix B. There is also an appendix that sets out the policy principles and objectives arising from the Incorporation documentation.

The expectation at incorporation was that PoJL's regulated tariffs would not over time grow beyond the increase in RPI. The remainder needed to support the required investment programme would be found from growing trading volumes, implementing commercial projects and delivering operating efficiencies. This material should be viewed in the context of PoJL's continuing aim to implement that pattern.

Long Term Capital and Funding Assumptions and Regulatory Principles from Incorporation

Part 1: Long Term Capital and Funding Assumptions

The table below summarises the funding assumptions and justifications for the long term capital and funding assumptions, this is explained in more detail Appendix A.

Category	Assumption	Justification
Starting Point	Long term foundation and business philosophy are established with the Case for Incorporation documentation and the Air & Sea Ports Incorporation (Jersey)	Our base assumptions are borne from the Case for Incorporation and the Air and Sea Ports Incorporation (Jersey) Law. The information contained in these documents formed the basis upon which States of Jersey voted in favour of incorporating PoJL. The long term assumptions established for the modelling of the business remain true, and are reviewed annually through our Strategic Business Plan process.
Business Planning and Forecasting Assumptions		
General Inflation	Modelled at 3% per annum	3.3% per annum is the very latest view from SoJ Fiscal Policy Panel on long term inflation.
Business Volumes	Long Term business volume growth: • Air Passengers: 0.8% per annum long run • Sea Passengers: 0.0% per annum long run • Freight & Fuel: 0.53% per annum long run	Baseline (Case for Incorporation) Air passengers this was RDC Aviation and for Marine business this was Fishers Associates, validated through Scrutiny review independently using York Aviation and MDS Transmodal. Most recently, Mott MacDonald updated forecasts with the work performed on the Master Plan.
Investment Assumptions		
Long Term Capital Programme (LTCP)	£286m (uninflated) over 25 years of investments just to keep facilities open to current standards, last reviewed June 2018. It is the LTCP that is required from core business revenues.	Originally built from Case for Incorporation, validated by Capita Symonds and York Aviation, updated for current position and forecast.

Long Term Capital and Funding Assumptions and Regulatory Principles from Incorporation

Category	Assumption	Justification
Master Plans **Contained within the LTCP**	Airport: £42m for Integrated Terminal and associated regulatory investments Harbour: Phase 1 only @ £27m (Please note that further phases are being developed)	Airport Master Plan as per Stage 3 design estimates, validated by Corgan Harbour Master Plan as per Mott MacDonald plan
Commercial Projects	A portfolio of future investments designed to provide a commercial return.	As per 2018 Strategic Business Plan (SBP), last reviewed Sep 2018. Updated for live and forecasted commercial projects.
Debt Assumptions		
Net Debt on Core Activities	Limit set to 2.5-3.0x EBITDA, or currently £40m, until a regulatory long term price mechanism is established and proven.	We judge that 2.5-3.0x EBITDA is prudent for an early stage infrastructure business such as PoJL. Credit rating agencies would see this at the lower end of the Investment Grade spectrum for all companies.
Net debt on Commercial Projects	As available from institutions and partners on a project specific basis.	Debt may be raised solely against project assets but is usually more costly than Company debt and needs to be of a size to warrant the arrangement costs and issues.
Cost of Debt	5% Long Term, 3% Medium Term	Historic interest returns to investors has been 3%, combined with the Bank of England's target inflation rate of 2.5%, it would equate to a long run interest rate expectation of 5.5%.
Cost and Cost Pressures Assumptions		
Operating Cost Efficiency	A target to reduce the cost base by 0.2% per annum in real terms against Jersey's general and activity specific inflation levels.	PoJL is a highly regulated business, whereby many areas of fixed costs (ie volume independent) are determined by international compliance standards. Detailed analysis shows the extent to which the remainder is variable. We have high influence over 10% of total opex and moderate influence over 17%, leading to a target to reduce these costs by 1% pa and 0.5% pa respectively in real terms.

Long Term Capital and Funding Assumptions and Regulatory Principles from Incorporation

Category	Assumption	Justification
Depreciation of Fixed Assets	Determined by the 'Jersey Financial Reporting Manual' accounting standard as in the SoJ published accounts.	Upon Incorporation, SoJ transferred the assets to PoJL with an assumption that they would be maintained and replaced as required. JFREM uses a Depreciated Replacement Cost (DRC) methodology to ensure replacement value is maintained.
Public Service Obligations (PSO)	PoJL will provide identified obligations, such as maintenance of Historic Harbours and provision of Coast Guard Services that would not normally be the responsibility of a commercial business.	The PSOs are as specified in the Air and Sea Ports Incorporation Law, and the cost of provision of these is derived from the commercial operations of the business. PoJL are compelled in law to provide these services.
Community Support	PoJL will continue to support various community activities in the same manner as before Incorporation.	PoJL supports key island events (the Boat Show and Air Display), provides support to a variety of Clubs, Societies and Associations, and maintains heritage assets – all of which comes with a cost.
Dividend to Shareholder		
Dividend to Shareholder	No cash dividends until the company is financially self-sustainable.	SoJ does not budget to receive cash dividends from PoJL and similarly is not called upon to invest. We do however provide incremental cash to SoJ via the 20% corporate tax rate on utilities, as well as covering the cost of PSO obligations which in other jurisdictions are funded by the tax payer.
Funding Philosophy		
Funding Philosophy	Funding for the capital investments will come from a combination of cash generation from core operations and commercial projects, as well as debt raised without SoJ guarantee. We envisage a single till for all CICRA economic regulated activities.	Over time, we expect airport operations to fund the necessary airport investments, and harbour operations to fund the necessary harbour investments. However, capital projects are 'lumpy' by nature and in any given year airport or harbour investments may be weighted heavier. The Harbour also has to cross-subsidise the Coastguard and Historic Harbours.

Long Term Capital and Funding Assumptions and Regulatory Principles from Incorporation

Category	Assumption	Justification
Term of Regulatory Period		
Period of Pricing Mechanism	PoJL seeks to establish a 10 year regulatory framework, which will encompass major investment in both the Airport and Harbour.	Large infrastructure business such a PoJL require a long term approach both to its finances and to physically delivering the range of required investments. A 10 year period would cover significant investment for both the airport and harbour.

Long Term Capital and Funding Assumptions and Regulatory Principles from Incorporation

Part 2 – Regulatory Principles arising from Incorporation

Introduction

Absent direct policy direction to CICRA from SOJ government, we draw upon the documentation from the Incorporation process for guidance. It was on the basis of these documents that the States Assembly voted on and approved the incorporation of POJL. All documentation can be found at: https://www.gov.je/Government/Consultations/pages/portsincorporation.aspx.

This section seeks to identify key policy principles emanating from the process of incorporating POJL, further details of each principle and source references are set out in Appendix B.

Regulatory Principles

1. **Financial Self Sustainability**
   The aim of incorporating POJL was to ensure its long term financial self sustainability and to remove the considerable liability for ports' infrastructure from States of Jersey (SoJ). This means POJL must have sufficient resources for Financial Capital Maintenance of their assets, and therefore require an adequate return from the regulated business segments to operate, maintain, renew and (where appropriate) enhance the assets.

2. **Continued provision of non-commercial services**
   POJL are accountable to provide Public Service Obligations (PSOs) without financial recourse to SoJ. These include the provision of Coastguard services, maintenance of Historic Harbours and maintenance of territorial seas aids to navigation. These services must be provided from within the revenues of the company.

3. **Service levels and community support**
   At the time of incorporation, it was recognised that POJL provided a level of service through their facilities and also supported a range of clubs, societies and associations related to aviation and maritime activities. During the incorporation process, POJL pledged their continued support of these clubs, societies and associations, as well as continuing to provide commensurate services levels as delivered prior to incorporation. Such support must be provided from the revenues of the company if it is to be sustained.

4. **Effective and efficient port operations**
   The context of a highly regulated sea and airport operation means that there are minimum standards that need to be met simply to operate. These standards extend through to areas of our business requiring a minimum of resource to be operationally compliant, and hence those costs are relatively fixed even in the long term. Most of the other areas are then service level related, where minimising costs will lead to a reduction in the quality or quantity of service provided.

Long Term Capital and Funding Assumptions and Regulatory Principles from Incorporation

5. Price levels

Throughout the Incorporation documentation, reference is made that financial self-sustainability can be achieved without resorting to above RPI price increases. Additionally, it was recognised that the period preceding Incorporation hallmarked by a general approach to below RPI price increases created an unsustainable position. Therefore the Case for Incorporation and particularly the financial projections assumed price increases in line with RPI, which alone would not completely close the long term funding gap, however were necessary alongside greater commercial freedom to enable long term financial self sustainability.

Long Term Capital and Funding Assumptions and Regulatory Principles from Incorporation

Appendix A

The Appendix sets out a more detailed explanation of the Long Term Capital and Funding Assumptions that were summarised in Part 1.

Starting Point – Case for Incorporation

Assumption

The baseline for the business, operations, conduct and financial self sustainability objective are founded in the documentation created for the Incorporation of Ports of Jersey.

Justification

The process of Incorporation yielded a large amount of evidence to justify the incorporation of PoJL. All of these documents were subject to in depth Scrutiny review, and validated by external independent sources. During the process there was a vast amount of stakeholder and public engagement, where concerns and issues were raised and addressed. Ultimately it was this set of documents that was reviewed by States of Jersey Assembly and the Air and Sea Ports Incorporation (Jersey) Law which was voted on, and passed by the States Assembly (32 votes to 4 votes).

The full set of documents can be found at:
https://www.gov.je/Government/Consultations/pages/portsincorporation.aspx

The development of the Case for Incorporation involved creating a long term financial model. This model contained the first holistic view of the long term capital requirements of the business, which was independently reviewed. The fundamental long term asset base and investment programme of today is consistent with this foundation.

The financial model also contained 15 core business assumptions, including independent reviews of our projected business volumes. All of the assumptions in our long term financial modelling are reviewed annually through our Strategic Business Plan development which is submitted to our shareholder.

Finally, the Case for Incorporation set out the key principles of our on going business philosophy. In short, this demonstrated PoJL will continue to provide the essential services to the Island and on going community support, but to do so in a financially self sustainable manner. Absent of any change to government policy or profound changes in our business model, this is the direction that we wish to continue.

General Inflation

Assumption

We have modelled long run inflation in Jersey, as measured by the Jersey Retail Price Index (RPI), at 3% per annum.

Justification

It is important to recognise the role inflation plays as a part of any long term projection. Over the long term costs will rise and goods and services will become more expensive than they are today. It is important to have an agreed assumption about future inflation in order to be able to convert between real and nominal cost and revenue forecasts.

States of Jersey Fiscal Policy Panel's August 2018 Report[1] identifies the inflation trend for RPIY as 3.0%, as identified in the following table from the report.

FPP central scenario

					Return to trend			
	2016	2017	2018	2019	2020	2021	2022	2023
Real GVA	1.2	0.1	1.6	1.5	0.0	0.0	0.0	0.0
RPI	1.7	3.1	4.2	3.4	3.3	3.3	3.3	3.3
RPIY	1.7	3.2	3.8	3.0	3.0	3.0	3.0	3.0

PoJL's long term planning assumption for RPI is 3%, in line with RPIY, which is used by States Treasury for forecasting purposes.

If price increases are unable to keep up with cost inflation profits will be continually eroded to the point of unsustainability.

Business Volumes

Assumption

Core business volume growth in our long term planning are as follows:

- Air Passengers: 0.8% growth per annum for the long run
- Sea Passengers: Flat - 0% for long run
- Freight & Fuel: 0.53% per annum long run

[1] https://www.gov.je/SiteCollectionDocuments/Government%20and%20administration/March%202018%20economic%20assumptions.pdf

Long Term Capital and Funding Assumptions and Regulatory Principles from Incorporation

Justification

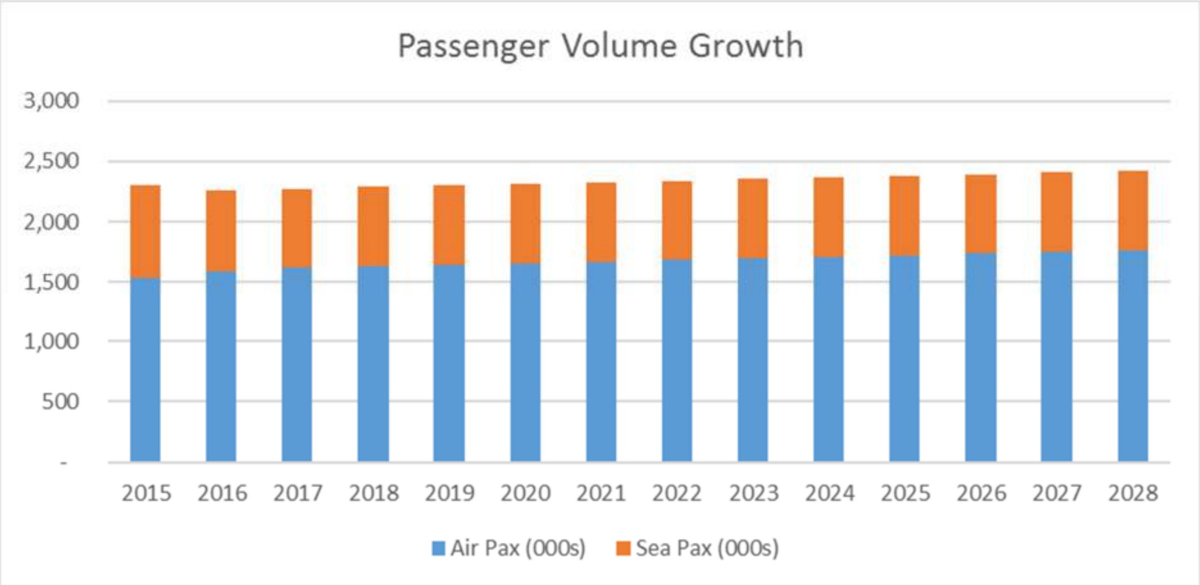
The original assumptions for long term business growth were determined during the process of Incorporation. RDC Aviation was retained for providing long run air passenger growth and Fisher Associates for Harbour long run passenger, freight and fuel growth.

These projections were validated through a Scrutiny Panel review process, where independent transportation experts York Aviation and MDS Transmodal confirmed the business growth assumptions.

Business volume forecasts from the Incorporation Process can be found:
https://www.gov.je/Government/Consultations/pages/portsincorporation.aspx

Both the airport and harbour growth assumptions are reviewed annually, on the basis of current performance. At this stage we have no contrary evidence that the long term trend would be different from the in depth reviews performed during the incorporation process.

Air & Sea Passengers



- Air Passengers have grown by 5.4% between 2015 and 2017. Conservatively we project a long term trend of 0.8% - consistent with the original RDC forecast
- Sea Passengers have declined by 14.6% between 2015 and 2017. In absence of any change, a flat growth assumption is prudent

In respect of the RDC Aviation forecasts, they noted in their Executive Summary "Long term traffic is forecast to grow at a CAGR of 0.8% (to 1.75m passengers) which in the context of historic performance (and challenges faced in the last 5 years) seems reasonable."

Long Term Capital and Funding Assumptions and Regulatory Principles from Incorporation

For Air Passengers, we have recently validated the growth projections against the long term requirements of the Airport Terminal as a part of our Integrated Terminal Project. It was important that we ensured our design caters for future needs of our customers and the Island.

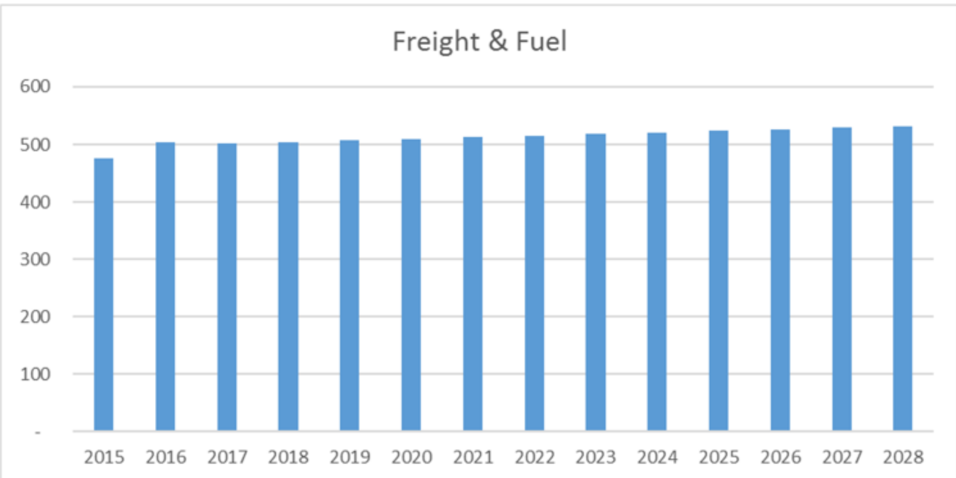
During our Integrated Terminal Design work, we have reviewed the Peak Hour Passenger demands assumptions against the actual Peak Hour Passenger demands from August 2016. This analysis resulted in a more gradual growth rate was used resulting in an Adjusted Arrivals peak in line with the original Masterplan and an Adjusted Departures Peak more indicative of the Hotel Industry Trend.

In respect of Fisher Associates sea passenger forecasts, they noted in their Executive Summary "Passengers by sea have declined as Jersey's tourism product has been restructured from bucket and spade to boutique spa, and because of competition with low cost airlines, although the volume of cars has held up in recent years."

In the case of the Sea Passengers, given the sharp decline in passengers since 2015, we would expect to see a recovery in this market. However, our business judgement is that we should project a flat (or 0%) growth in sea passengers over the long term until we have confidence that growth may return.

We are working closely with Visit Jersey to grow our inbound tourism. The ambition of Visit Jersey to reach one million visitors by 2030 is key goal in our long term planning and would reflect a 2.5% compound annual growth from the 2017 base of 727,000 visitors. Visitors contribute a significant proportion of passengers to our total passenger volumes, but total passenger growth is also dependent on both business and resident travel. For long term financial modelling of our business, a 0.8% growth rate for overall passenger volumes remains a valid assumption until such time as we have a firmer track record of visitor growth to amend our assumption.

Freight & Fuel



- Combining freight and fuel ensures there is no distortion arising from the containerisation of fuel
- We have used Mott MacDonalds 'low growth' projection for freight, and their moderate shift in energy consumption to arrive at a 0.53% long term growth

In respect of freight and fuel, Fishers Associates noted the following, "The circumstantial conclusion is that even though population has grown 20% since 1990, whilst GVA is now at a similar level, this has not resulted in an increase in imports because individual spending power has declined on average, and sectors of the economy that generate physical movement of goods have also declined. The latter has also led to a reduction in exports".

We have seen a growth in freight & fuel volumes since the 2009 recession and the 2012 loss of Low Value Consignment Relief (LVCR), where both events had caused a decline in volumes. In recent years freight and fuel volumes have remained relatively flat.

As a part of our Harbour Master Plan project, we have reviewed the volume projections for Passengers, Freight and Fuel to ensure St Helier Harbour can continue to provide the necessary facilities for future demand. There are two 'game changers', which are the likely long term decline in petroleum products and the potentially significant uplift in aggregate imports should the on island production of aggregates cease. We have insufficient information at this stage to revise our long term projections.

Considering the detailed and most recent projections performed by Mott MacDonald in our Harbour Master Plan developments, we have used their 'low freight growth' and their 'moderate shift to electricity in transport & domestic use' assumptions to arrive at a weighted growth figure of 0.53% per annum over the long run.

It is our understanding that permit extensions for both aggregates and sand have been submitted and are likely to progress. However, extensions for sand are likely to be limited to much shorter timescales and therefore could represent a material growth in freight requirements within 3-5 years. Whilst we do not have sufficient information to adjust our long term planning at this stage, we will continue to monitor the situation as it could have a material effect on infrastructure requirements.

We have a prime uncertainty in how Brexit will impact our business volumes. At this stage there is insufficient detail upon which to change our assumptions. We are monitoring the situation closely, and will review our assumptions as clarity emerges.

Long Term Capital and Funding Assumptions and Regulatory Principles from Incorporation

Long Term Capital Programme (LTCP)

Assumption

£286 million (un-inflated, 2018 as base), c. £430million (inflated) of capital investment is required over the next 25 years. Substantially these investments are simply to keep the ports open, safe and secure to current operational compliance whilst providing the same levels of service.

Justification

The original LTCP was developed during the process of Incorporation, where in the documentation a £276m (uninflated) or £420m (inflated) capital funding requirement was identified to keep the ports open, safe and secure operating to prevailing service standards. The LTCP was independently validated by Capital Validus, where they stated:

<u>Harbours</u>

- Forecast are well considered and prudent
- Robust with no obvious omissions from the forecast
- Operationally appears sensible and considered

<u>Airport</u>

- Comprehensive and reasonably robust – variation likely – possibly deferrable

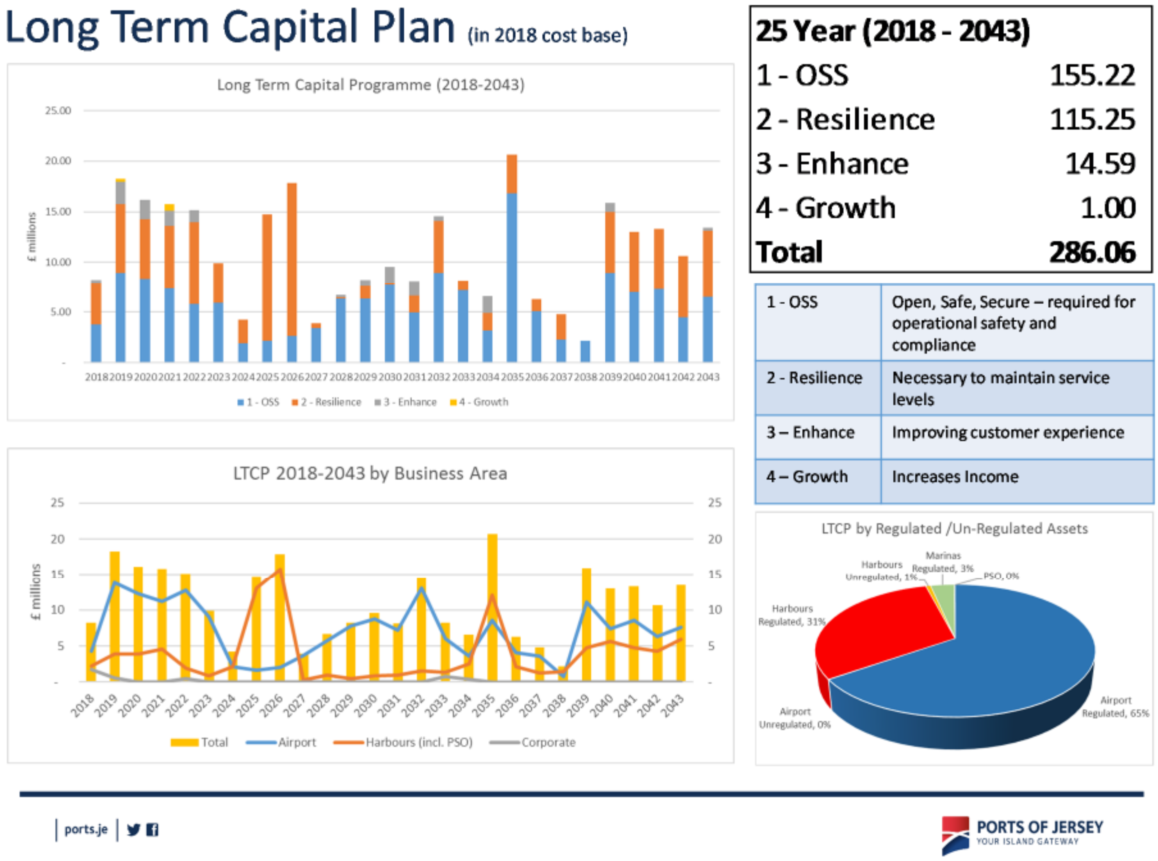
The LTCP was then further subjected to review by the Economic Affairs Scrutiny Panel, and their independent advisors York Aviation and MDS Transmodal. All in all, the LTCP scale is considered prudent for an infrastructure business such as PoJL.

The LTCP is periodically reviewed, at least annually, to cater for changing asset conditions, regulatory changes and prioritisation. The current version was reviewed in June 2018 and approved by PoJL Board. This version fully contains the required investment of the Airport Integrated Terminal Development and Phase 1 of the Harbour Master Plan.

Current LTCP

The current LTCP contains c. 150 areas of capital investment. We have categorised those across four areas – OSS (open, safe and secure), resilience, enhancements and growth.

Long Term Capital and Funding Assumptions and Regulatory Principles from Incorporation

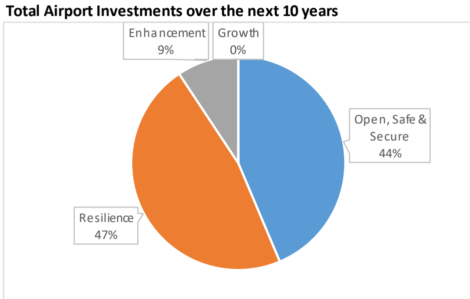


Over the next 10 years, PoJL intends to invest £124m (in 2018 prices) in Island Infrastructure. Two drivers for our investments are:

1. Ensuring the Gateways to the Island remain Open, Safe and Secure – and this category of investment is primary to address this ambition whilst remaining operationally compliant to regulatory standards.
2. Operational Resilience – where we invest to ensure the Ports can be open and operate, where as Island Gateways PoJL have greater requirements than similar operations in the UK where there are alternative potential gateways. For example, we can not divert aircraft to, say, Birmingham and bus people back to Jersey

Airport LTCP	2018-2022	2023-2027	Total
Airport Master Plan			
Open, Safe & Secure	3.6	3.0	6.6
Resilience	24.5	5.4	29.9
Enhancement	6.0		6.0
Growth			
Total Airport Master Plan	34.1	8.4	42.5
Airport Infrastructure & Equipment			
Open, Safe & Secure	16.5	8.7	25.2
Resilience	2.9	1.4	4.3
Enhancement	0.8		0.8
Growth			
Total Airport Infrastructure & Equipment	20.2	10.1	30.3
Total Airport LTCP	**54.3**	**18.5**	**72.8**

Total Airport Investments over the next 10 years

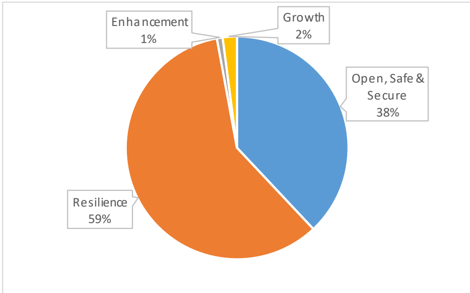


Long Term Capital and Funding Assumptions and Regulatory Principles from Incorporation

91% of Airport investments are targeting Open, Safe & Secure as well as Operational Resilience.

Harbour LTCP	2018-2022	2023-2027	Total
Harbour Master Plan			
Open, Safe & Secure			
Resilience		26.8	26.8
Enhancement			
Growth			
Total Harbour Master Plan	-	26.8	26.8
Harbour Infrastructure & Equipment			
Open, Safe & Secure	14.2	4.2	18.4
Resilience	0.8	1.0	1.8
Enhancement	0.4		0.4
Growth	1.0		1.0
Total Harbour Infrastructure & Equipment	16.4	5.2	21.6
Total Harbour LTCP	**16.4**	**32.0**	**48.4**

Total Harbour Investments over the next 10 years



At the Harbour, 96% of the planned investments are for Open, Safe & Secure or Operational Resilience projects.

Investment areas for the next 10 years contained in the Long Term Capital Plan

Ports of Jersey Infrastructure Investments	2018-2022	2023-2027	10 Year Total
Airport Investments			
Integrated Terminal Projects	34,050	8,400	42,450
Major Airport Projects	10,250	1,450	11,700
Areas of Other Infrastructure Investment	9,990	8,655	18,645
Airport Investments	**54,290**	**18,505**	**72,795**
Harbour Investments			
Harbour Master Plan	-	26,819	26,819
Major Harbour Projects	8,850	1,000	9,850
Areas of Other Infrastucture Investment	7,572	4,250	11,822
Total Harbour Investment	**16,422**	**32,069**	**48,491**
Corporate Investments			
Finance System Transformation	1,400	-	1,400
IT Investments	1,450	-	1,450
Total Corporate Investments	**2,850**	**-**	**2,850**
Total PoJL Infrastructure Investments	**73,562**	**50,574**	**124,137**

The initial five year period is characterised by higher investment at the Airport than at the Harbour. This changes in the second five year period, whereby we will see higher investment at the Harbour.

Prioritising investments for both financial and management delivery capability is an important aspect of our Long Term Capital Plan reviews. The rationale for prioritising Airport investment in the initial five years is due to an immediate regulatory requirement to address the airfield obstacles (eg Arrivals Building and Hangar 4), security measures (eg 30 metre stand off zone) and airfield configurations (eg taxiway alignment and stands).

The harbour does not have any immediate regulatory compliance requirements, and investment is more aligned to operational resilience and capacity requirements. Given our volume forecasts, addressing the capacity requirements is a future rather than immediate need. Hence, we have projected harbour resilience investments into the second five year period. Business and operating environment changes form a part of our Long Term Capital Plan review, and therefore should situations materially change we will review our prioritisation.

Growth Investments being scoped but not yet in the Investment Model

Potential Investment	Description
Airport – Multi-storey Car Park	Investing in a Multi-Storey Car Park will create more car parking capacity, free up property for development and improve customer access to the terminal.
Airport Estate Development	Various sites around the Airport, such as Staff Car Park, Eastern Apron, areas of the main car park, 'old' arrivals site and sites around the airport. All hold potential for both aviation and non-aviation related businesses.
Harbour Master Plan & Property Development	Only Phase 1 is included in the model, all subsequent phases have not been included. Freeing up New North Quay (among other locations) for property development (residential, commercial, leisure, public realm)
ATC Services Expansion	Remote Tower Services are included in the Commercial Projects, but a rapid expansion could lead to greater investment and return potential for both Remote Towers and ATC Services
Marine Services Growth	A single new vessel is included in the commercial projects, but investing in more vessels and equipment to expand the business is not included
Facilities Management Business	Expanding the services we provide from Engineering to bring in new contracts for equipment and building maintenance
Any other opportunities	PoJL continues to identify and develop new investment opportunities, which will be developed within the overall portfolio of investments

The above investments are primarily growth opportunities, some of which will require infrastructure investment to be identified in our LTCP.

Master Plans

Assumption

The initial phase of the Airport Master Plan is contained in the Integrated Terminal Project, at a projected investment of £42 million. The Harbour Master Plan Phase 1 is the starting point for further redevelopment of St Helier Harbour, and is projected to be £27 million.

Justification

Master Plans are an important part of any infrastructure company. They are necessary to provide context and phasing of investment projects across the entire operations. Infrastructure companies need to plan on very long investment horizons given the nature of the assets employed.

Importantly, they are not committed investments in their own right – rather from the Master Plans investment projects will flow, with investment approval and funding approved by the Board on a case by case basis. However, without them placing the individual projects into the wider context is challenging.

Both initial phases of the Master Plans are contained within the LTCP. During the proposed regulatory period the next phases on the harbour plan will be further developed and consulted upon, leading to further investment requirements.

Airport – Integrated Terminal Project - £42 million

The Integrated Terminal Project is necessary in order for Jersey Airport to remain compliant, as airfield obstacles (such as the Arrivals Building and Hangar 4) need to be removed and the Alpha Taxiway needs to be re-aligned. To accomplish this a new arrivals facility needs to be provided. In addition, there are a number of assets (such as the Departures Building and Passenger Pier) which need investment.

The Integrated Terminal provides the best solution to address both the compliance requirements and the asset investment needs. Other options were examined, but discounted as either not adequately addressing the compliance requirements or were higher cost.

Deliverables from the Integrated Terminal include:

- Maximising the footprint of the main terminal building, and providing more useable capacity
- Removal of airfield obstacles, and re-alignment of the Alpha Taxiway
- Expanded security capacity to conform with throughput requirements to IATA Code C Standards

- Enable existing landside ASIAD compliance standards to be met
- Improved retail and lounge space for departing passengers
- Improved operating efficiency for the Airport Terminal operations and maintenance

The Integrated Terminal Project has been independently validated by world leading Airport developer, Corgan Aviation who remarked:

"The Airport and its Design Team have presented an efficient solution for the consolidation of arriving and departing functions into one facility – the 'One-Box' Solution. The programming and design is rational and consistent with typical Aviation practices"

Stakeholder Engagement – Integrated Airport Development

Throughout the design and development of the Integrated Airport Development we have engaged widely across the spectrum of customers and users of our facilities. These groupd included passengers, customers (airlines and business partners), concessionaires, regulatory and enforcement bodies (ie police, customs, CAA, EASA), public using our facilities and people who work at the airport. Additional specific feedback sessions included:

- Public/Town hall drop in sessions to discuss the plans
- States Members & Breakfast Briefings
- Targeted customer feedback and input for distinct customer/demographic design requirements; by way of public/customer design sessions these included workshops for (but aren't limited to)
    - Passengers with specific travel requirements & disability groups
    - Departing passenger experience workshops open to the public
    - Arrival Passenger experience workshops open to the public
    - Parking at and visiting the airport
    - Future technology (Generation XYZ)
    - Passengers of the future/young travellers today (Pathways)
    - Passenger Journey
    - Use of automation (self bag drop, e-gates etc)
- Airline engagement sessions – what they expect & what they need for the future
- Social media – Our web pages provide information and are a regular source of feedback regarding what people expect, think or have experienced elsewhere
- TV, Radio and media in general – we use all forums to help communicate plans further and promoting broader public/customer engagement
- Engagement of a 3rd party design house from America to analyse and determine design appropriateness independently against future trends and improved passenger experience

Examples of changes to our design planning as a result of these engagement sessions include:

- A calming place for passengers with specific requirements (autism etc) was requested during a workshop and is now incorporated in our design

- Location, messaging and size of signage for the visually and hearing impaired was developed through a workshop with those passenger groups
- Our revised customer services and PRM desks design, location and facilities were all developed through our stakeholder sessions. Style of lighting, colour, height and technology for accessibility all changed/developed through these sessions
- We are now looking at the car park products we offer and how that can be improved
- How (and how many/placing) lifts and escalators will be used to support the movement of passengers with mobility restrictions was developed within our workshops
- World duty free and Casual Dining Group worked extensively with us to develop specific design requirements they expect of their concession areas – we are building to their design
- We received a lot of comments regarding a children's play area which not is now in our design but also implemented in the existing departures lounge immediately
- We are looking into how we might better weather protect passengers as a result of feedback
- Lift and escalator orientation was changed in departures
- Departure lobby doors were changed to allow for better protection in bad weather
- Toilet locations and design have been changed – including larger disabled access facilities
- Relocation of lounge offerings
- How POJ may provide greater environmental solutions (Solar PV, recycling etc). We also implemented a water bottle emptying and refill station process to reduce single use plastics
- A new bike rack is being introduced and designed with people wishing to cycle here for work or travel
- Quite spaces are being designed into the lounge area for travellers wishing to escape noise or to work – again specifically requested by passengers

<u>Harbour Master Plan Phase 1 - £27 million</u>

Phase 1 of the Harbour Master Plan contains the initial investments in the St Helier Harbour. It has been informed by detailed volume forecasting models to ensure we have the capacity and facilities required to meet the future demands.

The main area of pressure at St Helier Harbour is the provision of capacity for ferry delivered freight (RoRo). We are approaching capacity buffers at the Elizabeth Terminal, and against the requirement for just in time logistics chain we must ensure adequate capacity.

Long term aims of the Harbour Master Plan are:

- Provision of adequate capacity to meet the Island's freight needs into the future
- Segregation of Commercial and Leisure operations
- Create opportunities for redevelopment for leisure, residential, commercial and public realm investment

Deliverables for Phase 1 of the Harbour Master Plan include:

- Additional capacity at Elizabeth Terminal for the handling of RoRo freight, vehicles and passengers – with improved traffic flow.

- This additional capacity also creates 'swing space' to enable other areas of St Helier Harbour to be redeveloped
- Provide opportunities for property development for commercial, leisure and hospitality uses such as La Folie, Albert Pier and New North Quay

These plans have been developed through deep stakeholder engagement across all who are involved in St Helier Harbour by leading infrastructure engineering company Mott MacDonald.

Stakeholder Engagement – Harbour Master Plan

Our Harbour master plan work is not at as an advanced design stage as the Airport. However, it has been through an equally consultative approach.

The approach has been to understand all users, customers and public view of the challenges (operationally, commercially and as customers) of the existing port infrastructure in order to ultimately develop plans that address and safeguard the harbour for years to come.

As with the airport, POJ regularly meet with key stakeholder groups to determine existing and future requirements that influence our plans, these include:

- Passengers
- Boat Owner Associations
- Customers (Passenger and freight operators and those organisations that operate from our ports)
- Concessionaires – Shops, food and beverage providers etc
- Regulatory bodies – Police, Customs, States etc
- Public using our facilities
- Direct and indirectly employed workforces who operate at the Harbours

As with the Airport, engagement in this context is managed directly either through planned regularly held meetings, adhoc meetings and/or feedback received through a number of forums (email, Twitter, Facebook, phone etc).

Additional engagement relating to the Harbour master plan development has also included:

- Spring 2017 - Master plan stakeholder sessions with harbour users and customers
    - 24 stakeholder group sessions held over 3 weeks
    - 230+ comments and suggestions recorded, agreed and fed into the future design requirements
- Autumn 2017 – Second stage of stakeholder sessions completed
    - 35 Stakeholder group sessions
    - 300+ comments now received and incorporated
    - 30+ 1:1 key customer sessions held to determine future requirements of our key operators
- Winter 2017 – Master plan review sessions held to share design options with all contributors to the work to date

  - 6 group sessions held
- Feb 2018 – Finalised options taking into account all feedback shared with all stakeholder groups
  - 12 Stakeholder group sessions held
  - 6 core plan themes shared and agreed as correct

As the master plan is not at detailed design – the following key design parameters have been agreed with stakeholders as a result of all their feedback:

- ✓ Achieving clear segregation of leisure away from cargo operations to encourage safety, operational efficiency, improve leisure customer experience and to maximise commercial potentials
- ✓ Integration with SoJ's Esplanade Masterplan
- ✓ Maximise any under-utilised port land and water space for commercial and operational needs within the PoJ's jurisdiction.
- ✓ Ensuring the Port has sufficient capacity to handle future cargo growth demands
- ✓ Flexibility to adapt to different modes of cargo transportation in the future including larger and more varied vessel types , i.e. breaking away from single shipping operator reliance.
- ✓ Safeguarding the Island's ability to accommodate Jersey's future aggregate import volumes required
- ✓ Develop a solution which enables PoJ to continue commercial and operational expansion without having to rely on La Collette Reclamation land or other property/land outside of PoJ's governance and ownership
- ✓ Developing strategy and projects to 'unlock' New North Quay's commercial value
- ✓ Developing a strategy which accommodates as much of the Stakeholder's needs as possible within financial and commercial reason

Commercial Projects

Assumption

PoJL will undertake a portfolio of investments into commercial projects which will provide financial return towards the required LTCP infrastructure investments and further master plan investments.

Justification

One of the main benefits of incorporating PoJL was to enable greater commercial freedom for the company to pursue growth projects. Recognising that the prevailing business model was insufficient to ensure long term self-sustainability, the Case for Incorporation of PoJL identified financial improvements that would arise from the company investing in Commercial Projects.

PoJL has made good progress to date, having delivered new commercial activities such as:

- Development of the Airport Cargo Centre
- Retendering of Airport Concessions
- Expansion of Fuel Distribution business
- Expansion of Marine Services
- Developing and growing the Jersey Ships Registry

Live projects include:

- Elizabeth Terminal Restaurant
- New Corporate Aviation Hangars

Projects in the pipeline include:

- Expansion of Air Traffic Control Services, via Digital Towers
- Expansion of Marine Services, though investment in vessels and equipment
- Property development projects around our estate

For the purposes of Long Term Planning, PoJL has adopted a portfolio approach to commercial investments. Recognising that some may not be delivered and the financial returns derived from those investments may perform better or worse than initial projections, it is important that PoJL continues to balance investment/return levels on a case by case basis.

In order to ensure funding is available for these commercial projects, PoJL's base assumption is that they would be funded through debt – and therefore must be able to service the debt as well as deliver a financial return.

Cash Flows from Delivered Projects

PoJL have delivered six commercial projects which will bring in £2.6m of new revenue per annum that had not existed prior to the drive for Incorporation.

Cash Flows from Commercial Investments

During the next 10 years, PoJL have identified c. £30m in investment opportunities. Three projects are currently in progress, with a further 10 which may be developed in the period. Given the long run nature of these investments, which are required to support the investment in PoJL's Long Term Capital Plan (LTCP), Net Cash Flow in the immediate periods is negative. However, over the life of the projects the Commercial Projects Investment portfolio provides the needed income to support continued investment in the infrastructure of the gateways.

Long Term Capital and Funding Assumptions and Regulatory Principles from Incorporation

Commercial Projects Portfolio

Continuing Cash Flows from completed projects since the drive for Incorporation
£000s

	2018-2022	2023-2027	2027-2042
Net Revenue	11,331	11,331	33,993

Note: Investments made from 2014-2017 in six projects to deliver these revenue flows

Cash Flows from Commercial Projects currently in progress
£000s

	2018-2022	2023-2027	2027-2042
Projects	3		
Investment (loan monies)	14,745	0	0
Capital & Interest Repayments	-9,548	-9,548	0
Net Revenue	5,130	8,140	26,175
Net Cash Flow	-4,418	-1,408	26,175

Cash Flows from Commercial Projects currently in the pipeline
£000s

	2018-2022	2023-2027	2027-2042
Projects	10		4
Investment (loan monies)	14,870	0	5,500
Capital & Interest Repayments	-3,061	-9,629	-14,137
Net Revenue	1,537	11,557	45,752
Net Cash Flow	-1,524	1,928	31,615

Managing a portfolio of investments into commercial projects is fluid as new opportunities emerge, and existing projects get developed. The basis of investment may change as a project moves through the pipeline. For example, instead of wholly developing a project, the Board of PoJL may decide to partner the investment, or even allow a developer to do the entire project and PoJL accepts a lower risk return from, say, ground rent.

Further, projects may be added, advanced or removed from the pipeline as the analysis is developed. The current pipeline has 4 projects identified for future consideration (ie beyond the next 10 years), but these may be advanced as the investment cases are developed.

Net Debt

Assumption

PoJL cannot fund the necessary investment from just its contemporaneous earnings and reserves. It will also need to raise a substantial level of debt to finance both the planned investment in PoJL core facilities and its supporting commercial investments.

The Board's view is that a maximum ratio of 2.5 – 3.0 times EBITDA would be prudent for PoJL at this stage. A final decision on this will depend on the nature of the regulatory settlement with CICRA and the considered views of potential lenders and our shareholder following such a settlement.

In addition some of PoJL's future Commercial investments may be capable of being funded with debt secured on those assets and without further recourse to PoJL.

We do not envisage SoJ providing a guarantee, however lenders will take some comfort from SoJ being the sole shareholder.

Justification

It was envisaged at the time of the Case for Incorporation that PoJL would require a debt facility. Investing in infrastructure is 'lumpy' by nature, and therefore it will not evenly match the annual cash generation of the business.

The role of Debt

PoJL plan to finance a portion of its investment plan with third party debt provided by banks or institutional investors, as described in more detail below. Debt finance will accelerate the availability of funds for the investment, but will need to be repaid from future earnings, and lenders will need to be assured of the certainty of future revenues if they are to lend to PoJL.

Consequently, the availability of such debt finance does not remove the need for agreeing with CICRA a reliable long term funding plan and regulatory settlement. Indeed, neither medium nor long term debt finance will be available until such an agreement is reached as lenders will wish to be satisfied that revenues in the future will be sufficient to service and repay debt. They will seek certainty and long-term stability in any regulatory settlement. We do not envisage SoJ providing a guarantee as it would be counter to the principle of incorporation.

The level of debt at any year end will not represent the maximum during that year due to normal fluctuations in working capital. We assess that this could, at its peak, require extra debt funding of c. £10.0 m.

Long Term Capital and Funding Assumptions and Regulatory Principles from Incorporation

Treasury Options

A company such as PoJL has three options in selecting its financial partners and all of these sources could play a role in the financing of PoJL

- Banks, who typically lend for up to 5 years, providing a revolving credit facility ("RCF") which permits a Borrower to drawdown funds over the term of the 3 - 5 year facility. A revolving credit also permits the Borrower to use these facilities to finance working capital requirements over the short term.

  Typically, these facilities are unsecured and are repaid at term with a single, bullet repayment which requires the Borrower to refinance the facility prior to term to meet this repayment. Interest is usually at a variable rate linked to the wholesale funding costs of banks with an additional margin charged for credit risk, a commitment fee for undrawn amounts charged at 40%-50% of the drawn margin.

  A front end fee is also charged as a percentage of the face amount of the Facility. Other charges would include the significant transaction costs, such as legal costs, which would be for the account of the Borrower.

  Most UK corporates have RCF's in place to fund working capital, short term cash flow benefits or as a contingency source of finance and if possible seek to refinance any long term debt with institutional investors.

- Institutional Finance, provided by financial services companies such as life insurance, pension funds and other similar fund managers, who are not usually able to provide an RCF but can provide longer term finance repaid from 5-30 years, usually at a fixed rate of interest which is calculated as a margin over the relevant UK Government Gilt rate.

  In the case of PoJL, this is likely to be an unsecured loan and repaid with regular instalments over its life, often profiled as an annuity. Although some providers will accept staged drawdowns of these loans, they are less flexible in respect of drawdowns and repayments compared to an RCF. With longer term finance, Lenders can insist on significant built in penalties for prepayment, such as SPENS clauses. As with Banks, there are front end fees and transaction costs of a similar amount as would be payable under an RCF arrangement.

  These loans can be sourced bilaterally from such institutions such as Legal & General, Aviva and the Prudential (and can also be sourced through a private placement with a wider range of investors organised by a Bank). The funding required by PoJL is too small for a public bond issue and it would be unlikely that a rating from a credit agency would be required to access this market.

- Project Finance and Asset Finance, including certain forms of Real Estate Finance, are best understood as different forms of non/limited recourse debt which Borrowers can use to finance particular projects or assets separately from their core activities. The main benefit from this approach is a mitigation of the risk to the balance sheet of the sponsor if the project or asset underperforms. It can also be used to achieve far higher leverage on an individual investment, typically up to a 60% Loan to Value ratio, which boosts returns, and it can be helpful in financing partnerships and joint ventures. Such schemes can utilise either institutional or bank finance.

PoJL may use this approach to fund some of its commercial investments. The transactions costs involved with this type of finance are higher, as are margins, which makes it less attractive for smaller investments, except for purely real estate transactions.

PoJL's Approach

PoJL will finalise its Finance Plan to reflect any regulatory settlement from CICRA and, inter alia, the outcome of negotiations with potential lenders.

The Board's provisional view is that a core debt level of **2.5 – 3.0 times EBITDA** would be prudent for PoJL at this stage.

The Board will pursue discussions with Banks to put in place an RCF and also consider a long term institutional loan, either to refinance drawings under the RCF on to a long term basis, or partially replace the need for the RCF. PoJL will also seek to maximise the use of project finance for commercial ventures where practical and provided its higher transaction costs are affordable.

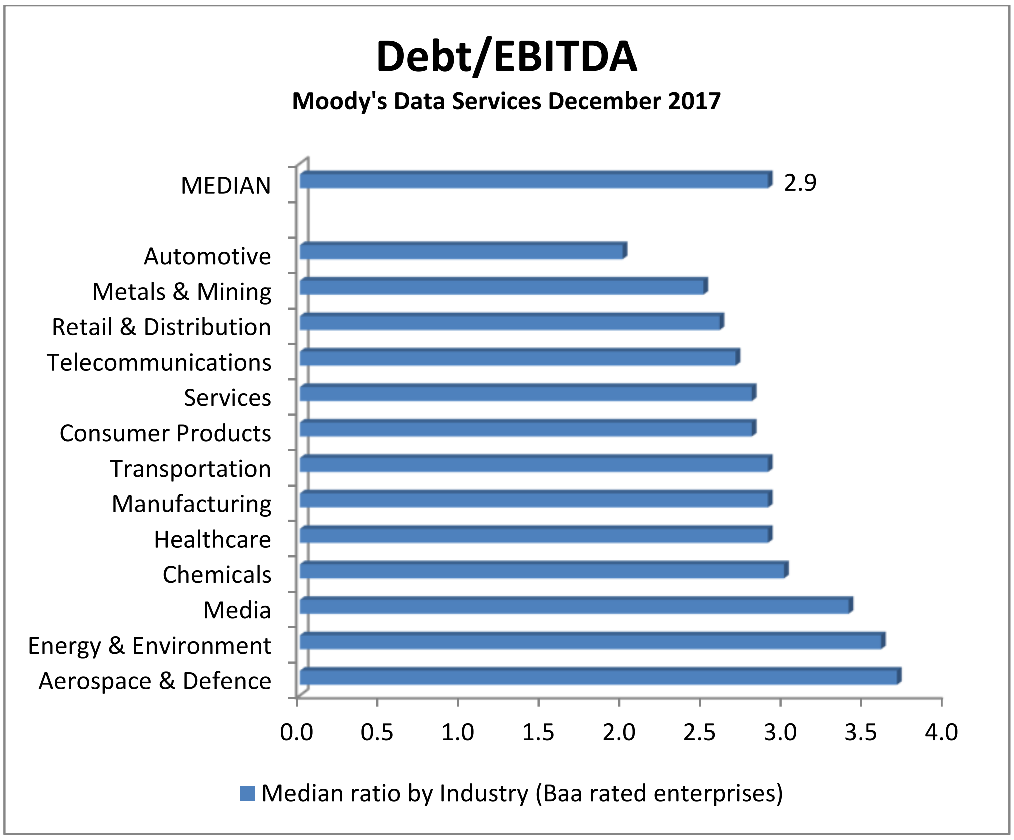
Market Data comparatives

In September 2017 Moody's, the global ratings agency, published a periodic update of the key financial metrics displayed by the non-financial corporates they have given credit ratings. The range for Debt/EBITDA was:

Rating scale	Median Ratio
Aaa	1.9
Aa	1.8
A	2.3
Baa	**2.9**
Ba	3.7
B	5.2
C-Caa	8.1

Ratings of between Aaa and Baa are considered by institutions to be 'Investment Grade' for instruments such as bonds, with Baa representing the lowest qualifying scale.

Within that Baa scale, Debt/EBITDA ratios do vary by Industry but visibly cluster as shown below:



Transportation is at the overall median at 2.9 times.

Cost of Debt

Historically, interest rates have offered investors a real return of 3% on average, with significant variances around the mean, which with the Bank of England's target inflation rate of 2.5% would give an interest rate expectation of 5.5%. Hence our long term strategic plans have been based upon an all-in interest rate of 5%

However, since the Financial Crisis, interest rates have been considerably lower than this "normal" as Central Banks have engaged in QE and kept interest rates extremely low by historical standards. Today, Base Rates set by the Bank of England are 0.75% pa and LIBOR for six months is 0.91% pa. The 10 year Gilt yields 1.38% pa.

PoJL will not use derivatives to speculate but to establish the optimum interest rate profile, balancing risk with the cost of certainty. Swaps can be used for Bank transactions to fix the interest rate for floating rate loans and vice versa. For illustration only we might aim to have two thirds at fixed rates and one third at floating rates.

If PoJL were to go to the debt markets today an RCF (ie not the Project Finance referred to above which may be more expensive), the margin over the relevant benchmark interest rate that we might achieve (including amortised upfront transaction costs), would be some 1.5% p.a, although this is an estimate at this stage. Final costs will only be clear after negotiation with debt providers, and variances will principally be determined by lenders assessment of the robustness of the regulatory settlement and the comfort of having the States of Jersey as our parent. With LIBOR at 0.91% this gives an all-in cost of Bank debt as 2.41% which after swapping out any interest rate risk and taking running commitment fees into account would give an estimated all-in cost of 3.5% pa.

These costs will change with time and are likely to move towards the long term trend rates. Already US 10 Year Treasury rates are near to 3% pa and US LIBOR for 12 months is 2.8% pa as Central Banks worldwide seek to raise rates to levels which exceed inflation, currently at 2.4% for the UK, a process that has just begun in the UK with recent Central bank rate increases. PoJL's borrowing costs are therefore likely to increase with time, depending in part on the outcome of BREXIT negotiations.

Operating Cost Efficiencies

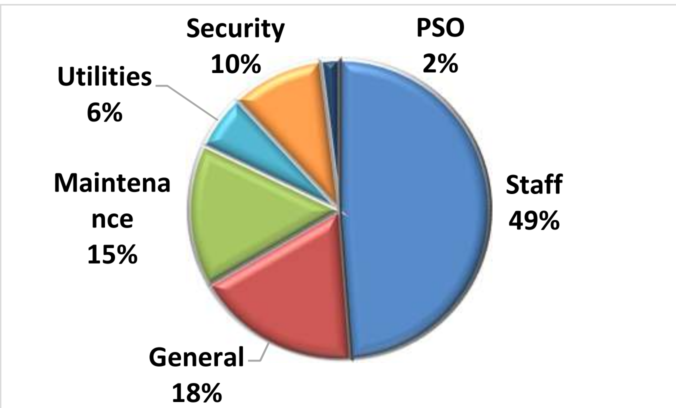
Assumption

Over the long term PoJL's cost base is projected to increase by RPI (3.0% in our modelling). We expect to continue to make efficiencies across the business as we have done to date. However with much of our cost base determined by international requirements, operational regulatory controls, and maintaining service standards - our ability to influence our cost base over the medium term is limited.

Justification

PoJL is the most highly regulated entity in Jersey. Safety, security and operational compliance are monitored against international compliance standards. It is recognised that PoJL will continue to be faced with additional requirements and higher standards. For example, with increased regulatory oversight from the European Aviation Safety Agency (EASA) and requirement to invest in the next generation of X-Ray equipment.

About half of our cost base are staff, and when including security costs and maintenance of our facilities this rises to 75%.



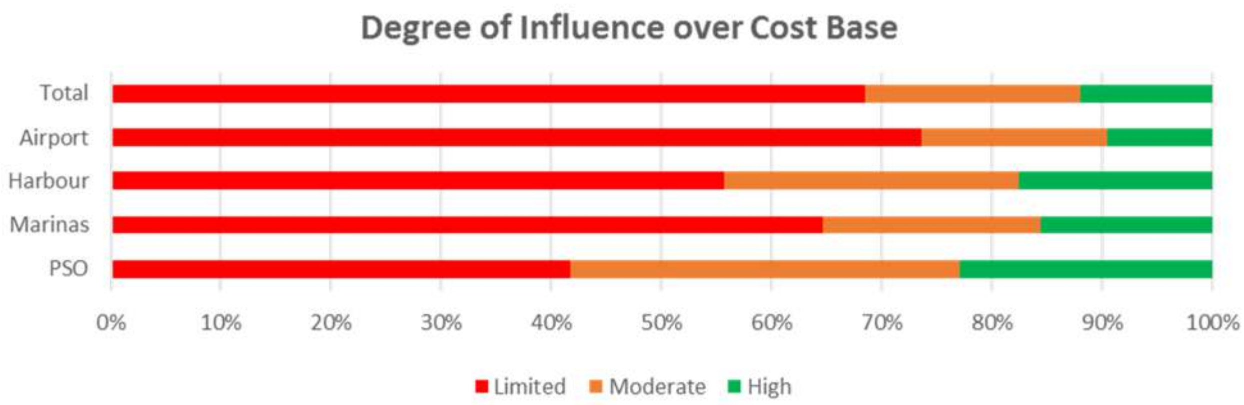
Long Term Capital and Funding Assumptions and Regulatory Principles from Incorporation

PoJL analysed our cost base into degrees of influence ability over the medium term between the different cost categories.

Ability to influence cost category

Cost Category	2016 Cost Base Limited	Moderate	High	Total	Percentage Limited	Moderate	High
Maintenance & Engineering	5,043,710	1,444,525	1,076,741	7,564,976	67%	19%	14%
Air Traffic Services	3,634,464	473,878	145,531	4,253,874	85%	11%	3%
Corporate Overheads	2,157,993	747,735	451,830	3,357,558	64%	22%	13%
Security	2,565,024	285,003	-	2,850,027	90%	10%	0%
Specialist Services	1,936,890	415,120	415,120	2,767,130	70%	15%	15%
Fire Service	1,743,183	326,847	108,949	2,178,979	80%	15%	5%
Terminal & Passenger Services	585,381	585,381	292,845	1,463,607	40%	40%	20%
Electricity	1,220,555	143,595	71,797	1,435,947	85%	10%	5%
Marine Ops	841,346	278,694	119,970	1,240,009	68%	22%	10%
Recharges for Contracts	882,622	60,320	-	942,942	94%	6%	0%
Forex & Banking	624,374	69,375	-	693,749	90%	10%	0%
Professional Fees	290,245	174,147	116,098	580,489	50%	30%	20%
General Expenses	131,034	207,514	225,699	564,247	23%	37%	40%
Equipment Hire / Purchase	416,321	52,040	52,040	520,402	80%	10%	10%
Marinas	311,850	103,950	103,950	519,751	60%	20%	20%
Coastguard	502,690	-	-	502,690	100%	0%	0%
Other Categories less than £500k	2,327,347	608,822	425,034	3,361,203	69%	18%	13%
Total	**25,215,030**	**5,976,946**	**3,605,604**	**34,797,580**	**72%**	**17%**	**10%**

Note: The above table contains operating cost categories, and exclude items such as bad debt write offs and revaluations



In order to open our ports, we require a minimum number of Air Traffic Controllers, a minimum number of Fire & Rescue people, a minimum number of Coastguard and VTS operators – these are driven by safety and compliance. Further in order to provide services to a level that consumers have become accustomed to and are to be reported to CICRA through the new regulatory reporting measures, we require a set number of people to deliver those services.

This means that we have limited or at best moderate influence over about 90% of our cost base in the medium term, and it is largely subject to RPI and other exogenously set price increases.

An example is Airport Security, where we have an obligation to screen 100% of departing passengers. We could save money by screening using only one security arch rather than three and still meet our 100% screening requirements; however departing passengers would face longer security queues and waiting times – which is something we would prefer to avoid to maintain our service levels.

Our facilities and equipment require ongoing maintenance to ensure they have the highest degree of up time possible. In addition to safety and security requirements, operational resilience is very important for an Island air or sea port. We cannot, for example, divert aircraft to another local airport and coach passengers back to Jersey if our airport is closed (as a similar airport on the UK mainland might do). PoJL feels maintaining this level of operational resilience is important, we would not want to reduce maintenance programmes on various assets and take a risk that they might fail. We cannot compromise safety, so this may lead to periods of our facilities being shut whilst repairs are conducted (which could take days or weeks in some cases).

Impact of long run general salary increases

Given about 50% of our cost base is staff related, and most of these roles will be driven by either operational compliance requirements or maintaining service standards, the long run effect of increasing wages compared to RPI is a key component of our cost base.

According to States of Jersey's 2017 Annual Report, assumptions made by the pensions actuary state that the rate of general long term increase in salaries will outpace the Jersey Price Inflation.

	2017 % p.a.	2016 % p.a.
Jersey Price Inflation	2.90	3.25
Rate of general long-term increase in salaries	3.85	4.25

For PoJL long term planning, this is a signal that our cost base will come under even greater pressure than simply applying RPI.

Impact of increasing regulatory and operational burden

It is a fact of modern life that Regulation around everything we do only increases year on year. This is especially true of public transportation, where public safety and security are top priority. In Jersey, we face a number of additional challenges over our UK and French neighbours with regard to the regulatory environment we must comply with, even though from the outside we appear to be small regional airport and port. The necessary equipment, trained staff and resources to operate in compliance with applicable regulations is very expensive, often disproportionately to the number of passengers, or the perceived risk. It is often invisible to passengers and the general public that the freedom to travel to and from the UK as we currently do, and the ability to carry on flying when French controllers are on strike, is taken for granted.

Long Term Capital and Funding Assumptions and Regulatory Principles from Incorporation

To illustrate the cost of compliance for operating Ports of Jersey, it is useful to look at some real examples from the last few year, and what we face in the next three.

- Aviation Security : Passengers for Jersey travelling to and from the UK are subject to a higher level of security screening than their European counterparts. Often this translates to upgrading X-Ray and screening equipment earlier and to a higher standard. For example, the following equipment upgrades are required by Regulation (UK MSM) and their approximate Capital costs are noted alongside:
  Upgrade of Hold Baggage X Rays to Standard 3 by Oct 2020 - £2.5M
  Upgrade of Cabin Baggage X ray to Standard C3 (est deadline Nov 2021) £2.25M
  Introduction of Body Scanners - £300k per lane.

  Systems introduced recently as a result of regulation
  Critical Part Monitoring - £300k (2016)
  Explosive Trace Detection – upgrade mandated by new standard £100k
  It is worth noting that the requirements for the capability and competency of security agents operating the new equipment continue to become more demanding, and therefore more expensive. **Aviation Security Agents costs (OPEX) per annum £2.5M**
  Costs of UK external regulatory inspection per annum - £25k (opex)

- Airspace: Jersey operates controlled air traffic services inside of French airspace. In order for the service to be delegated to Jersey, the requirement for equipment, personnel and procedures is equivalent to that required by a member state (i.e. UK, France, Germany etc) who have the entire resources of a country to draw from. It is therefore very challenging for a small operation such as we are to meet all the obligations required by regulation. In addition, as Jersey is neither a 'state' nor a EU member, it must submit to oversight by the European Aviation Safety Agency directly, in order to obtain a certificate to operate. Even the UK and France don't have to face this challenge! Typical OPEX costs arising from this burden are:
  Dedicated Assurance Manager £80k/pa
  Independent Aviation Compliance Manager £50k p/a
  Quality Assurance Officer £40k p/a
  Annual Regulatory Oversight costs (EASA and UK-CAA) £65k

  Annual CAPEX for Air Navigation service equipment upgrades for compliance (based on 2018 – 2020) £700k

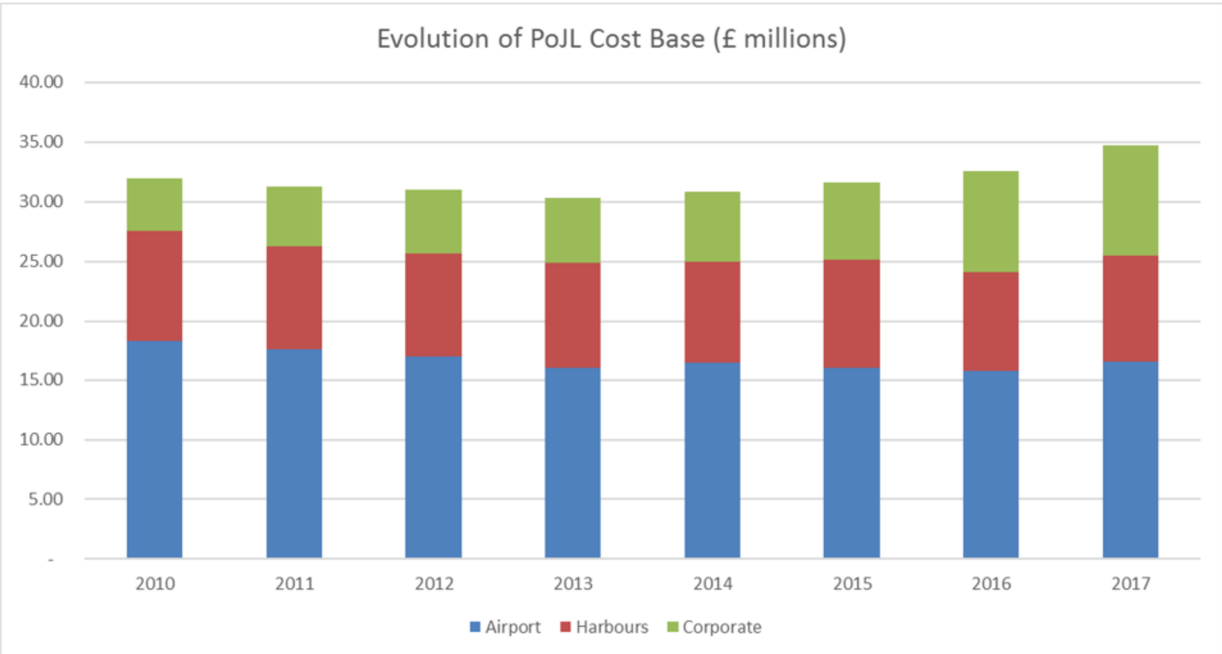
- Maritime Security: The Port of St Helier operates in compliance with international security regulations (ISPS – EC725-2004) and the enhanced measures required by UK, as we are the southernmost entry point into the UK. We are audited annually by the UK Department for Transport and requirements change as worldwide threats from terrorism to maritime operations change. In the last two years the New North

Quay operation was assessed as requiring significant increased security arrangements, due to the predominantly Load on/Load off cargo (LOLO). Upgrades included a fully compliant security fence surrounding the whole quay edge to 2.1m in height and vehicle screening checkpoint, gates, barriers, CCTV and personnel.
CAPEX £300k + annual OPEX costs £100k
Dedicated Ports of Jersey Security Manager- **OPEX £45k/pa**

Elizabeth and Albert Terminals operate X Ray and Metal detecting equipment for Passenger and vehicle screening, and these must be maintained and replaced on a planned basis. **CAPEX (annualised) £100k**
Maritime Security Agents costs (OPEX) per annum £600K

Arriving at an efficiency target

Making efficiency savings whilst not compromising compliance standards, maintaining service levels and retaining operational resilience is challenging – but we consider through smarter ways of working, notably achieved through our Acceleration Programme, we can minimise cost increases to below underlying inflation.



In the period from 2010 to 2014, PoJL managed to reduce our cost base through extracting efficiencies and synergies whilst within the Public Sector. In this period, PoJL achieved a compounded annual reduction in costs of 0.7%.

Having optimised the operation prior to Incorporation, the period from 2014-2017 saw an increase in costs by a compounded average of 3% per annum. Not only does this include absorbing increased regulatory burden and inflationary pressures, and servicing higher traffic volumes, but also the increased costs associated with operating as a limited company.

Such increases to the cost base included paying full parish rates, increased regulatory license fees (eg CICRA), increased audit fees from independent external audit, and increasing costs from insourcing support functions previously carried out by SoJ (eg payroll, IT, HR, treasury).

Given the transitions, the full year effect of the new cost base for our operations was established in 2017 when the final full year parish rates was in our accounts.

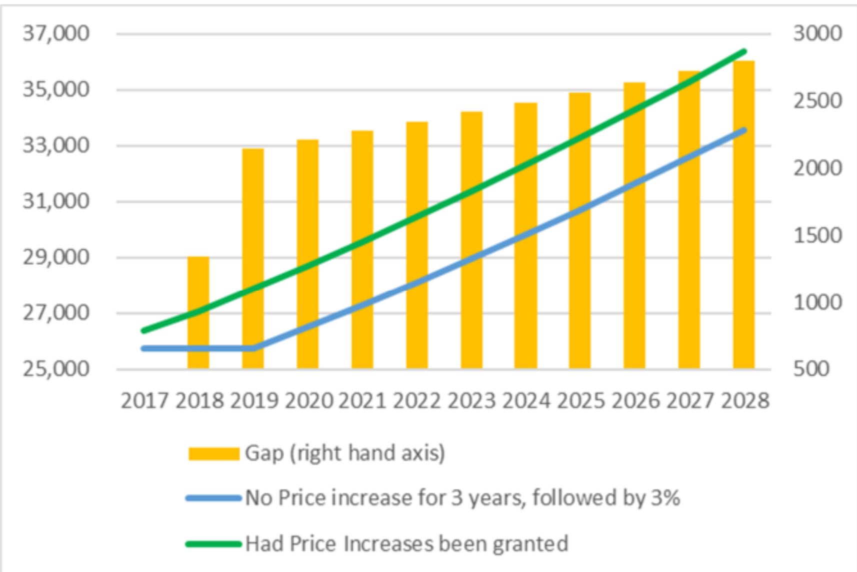
Efficiency Targets

	Limited	Moderate	High	Total
2016 Cost Base	25,215,030	5,976,946	3,605,604	34,797,580
Gross Efficiency Targets (Net from Inflation)	**0.0%**	**0.5%**	**1.0%**	**0.19%**

Our aim for an efficiency target is to minimise inflationary and regulatory pressures on our cost base through continued investment in new technologies, business process and delivering operational efficiencies. In the medium term, ie the next 10 years, against a largely fixed cost base, our goal would be to keep costs to a level of RPI less 0.2%.

Applying the Efficiency Target

Due to lack of agreement on Prices, PoJL is tracking £1.0m down on revenue per annum. Compounding for the long term equates to c£50m lost revenue.



Prior to incorporation SoJ increased tariffs annually as a matter of course. Since incorporation our tariffs have been frozen with the exception of CICRA sanctioning a one off increase of 0.9% effective from June 2015.

We would aim to reflect this annual efficiency target in future tariff increases after this Revenue gap has been closed.

Depreciation of Fixed Assets

Assumption

For the purposes of regulatory reporting, PoJL will use the asset valuation as determined by applying the JFREM Accounting Standard.

Justification

Upon Incorporation, all of the assets were transferred from SoJ to PoJL where PoJL was tasked to ensure their long term sustainability for the provision of open, safe and secure gateway facilities. Further, the PSO assets were to be maintained to their current standard.

The obligation for PoJL is to ensure that the viability of the infrastructure is maintained over the long term, and therefore to have the financial capability to reinvest in the asset base when it is required. Accounting for these assets using a Depreciated Replacement Cost (DRC) valuation methodology ensures the company is sufficiently profitable to be able to reinvest in the asset base. The JFREM standard values assets with a Depreciated Replacement Cost basis.

Upon Incorporation, PoJL adopted the FRS102 accounting standard – which is appropriate for a commercial entity. Asset valuation under FRS102 is performed on the basis of the amount of profit the asset base generates, and hence is divorced from the potential replacement cost of the asset base. Accounting for our assets under FRS102 standards will not provide sufficient profitability for PoJL to deliver against the aim of being able to reinvest in the assets when required.

PoJL is fully consolidated into the SoJ accounts, and SoJ reports the assets that were transferred upon incorporation under the JFREM accounting standard (which is the standard that SoJ applies across its entire operation).

The aim is that PoJL would become financially self-sustainable to enable reinvestment into the asset base, basically enabling a like for like replacement should an asset fail. The JFREM accounting standard is driven by a Depreciated Replacement Cost valuation, and hence provides the cost base upon which they could be replaced.

Long Term Capital and Funding Assumptions and Regulatory Principles from Incorporation

As at end 2017, PoJL's fixed asset register had 733 fixed assets with a Net Book Value of £390 million.

Asset Locations	Fixed Asset No.	NBV 17 JFReM	NBV 17 FRS102
Airport	355	151,626	89,611
Harbours	251	121,522	30,811
Marinas	45	80,123	3,875
PSO	82	36,898	2,362
Grand Total	**733**	**390,169**	**126,659**

Categories of Fixed Assets

Jersey Airport	NBV 17 JFReM	NBV 17 FRS102
Airfield Operations	59,648	26,787
Airport Property	72,977	47,159
Airport Security	320	97
ATC	3,753	3,697
Engineering	205	94
Fire Service	3,258	782
GSTS	4,106	1,970
IT	41	49
Other	11	-
Passenger Handling	6,732	8,443
Security	575	535
Total Airport	**151,626**	**89,611**

Jersey Harbours	NBV 17 JFReM	NBV 17 FRS102
Boats & Vessels	1,249	262
Coastguard	223	46
Commercial Port	36,165	29,599
Fisheries	920	6
Freight & Fuel	13,965	369
Nav Aids	1,031	11
Piers & Quays	67,922	519
Pilot & VTS	49	-
Total Harbour	**121,522**	**30,811**

Long Term Capital and Funding Assumptions and Regulatory Principles from Incorporation

Jersey Marinas	NBV 17 JFReM	NBV 17 FRS102
Boat Lifts & Parks	31	24
Marinas	80,092	3,851
Total Marinas	**80,123**	**3,875**

PSOs	NBV 17 JFReM	NBV 17 FRS102
Coastguard	213	128
Outlying Harbours	36,685	2,234
Total PSOs	**36,898**	**2,362**

Total PoJL	**390,169**	**126,659**

Utilising the JFREM accounting standard will allow PoJL to cover the Financial Capital Maintenance on a Depreciated Replacement Cost basis, and ensures the regulatory principles are aligned to the objective set by SoJ on Incorporation to ensure the asset base of the company is maintained over the long term.

Public Service Obligations (PSO)

Assumption

PoJL will provide identified obligations, such as maintenance of Historic Harbours and provision of Coast Guard Services that would not normally be the responsibility of a commercial business.

Justification

In the Air and Sea Ports Incorporation Law, which was the statutory basis to bring PoJL into existence, PSO obligations were placed on the company.

Article 6 (1) of the Law states:

6 Public service obligations of POJL

(1) POJL shall be responsible for discharging, in accordance with this Article, the following functions (referred to collectively in this Law as "public service obligations") –

(a) co-ordinating, or providing resources for co-ordinating, maritime search and rescue within the Jersey Search and Rescue Region;

(b) maintenance of aids to navigation in territorial waters;

(c) acting as custodian of Jersey harbours;

(d) enforcement of shipping legislation in territorial waters;

(e) carrying out certain port State control functions;

(f) management of the Channel Islands Control Area.

These PSOs are functions of government that have been passed to the Harbour Authority and Airport Authority, where PoJL has been appointed by government to perform these authorities' functions. As we are compelled in law to provide these services, they must be provided from within the financial returns of the company. PoJL does not receive any grant income to support these functions.

The primary PSOs are maritime related, which relate to functions (a) through (e) in the Incorporation Law. The Channel Islands Control Area (CICA) relates to the controlled airspace where PoJL manages air navigation. Whilst the CICA is governed by an agreement between the UK and France for the airspace, the control is delegated to Jersey for which PoJL receives and important income stream for our operations.

The PSOs are fundamentally different between the Harbour and Airport.

Airport PSO

[Table Redacted – Commercially confidential]

The PSO is to provide Air Navigation Services to manage the Channel Islands Control Area. The income from this activity is renegotiated every 3-5 years, and is not fixed. Currently, the income is c. £6.3m per annum, but we are under continued pressure to reduce their costs for these services from the UK and French negotiating teams. Further, as the contract is denominated in Euro, there is a foreign exchange risk to the income stream.

The income provides the Airport with an important contribution to fixed costs. Were the value of this contract to reduce, or indeed become zero, it is unlikely that PoJL would be able to offset the lost income through cost savings and hence this would increase pressure on aeronautical tariffs.

Harbours PSOs

Harbours	2018-2022	2023-2027	2028+
Revenue			
Coastguard	-	-	-
Historic Harbours	3,281	3,803	15,445
Expense			
Coastguard	(5,967)	(6,918)	(28,094)
Historic Harbours	(4,351)	(3,653)	(14,835)
Net Harbours	(7,038)	(6,768)	(27,484)

The PSOs at the Harbour are of a different nature. Here they have an on going cost burden to the PoJL financials. These are activities that a commercial enterprise would not normally undertake, and indeed in other jurisdictions are centrally funded through government, such as the Maritime Coastguard Agency (MCA) in the UK.

In Jersey, it has been a historic position that Coastguard, maintenance of historic harbours and navigation aids in our territorial waters would be funded from harbour dues.

Beyond the operating costs to provide the Airport and Harbour PSOs, there is an element of Corporate Overheads, Tax and Capital Investments that are required to deliver the responsibilities of the PSOs.

Community Support

In addition to the legally prescribed PSOs, where the ability to influence a rising cost base is very limited, PoJL also provides substantial support to various community activities for the island. These include:

- Delivery of two of the island's most significant events, the Barclays Jersey Boat Show and the International Air Display (cost to PoJL for these events in 2017 was £260k)
- Continued support to a range of Clubs, Societies and Associations (c. £500k per annum in benefits)
- Continued maintenance of heritage assets, such as the recent refurbishment of Corbiere Lighthouse and replacement of the Maritime Museum Roof

These areas of community support are not operationally required for PoJL to continue to provide open, safe and secure operations. As such, they are activities that we have a choice to continue with.

These activities, as well as the PSOs, are very important to island life and through the process of Incorporation PoJL undertook to maintain these levels of support. Certainly, the Economic Affairs Scrutiny Panel reviewing the Case for Incorporation placed heavy emphasis on PoJL's continued provision of these activities. Given our assumptions for Incorporation also included RPI level price increases, our ability to continue to fund these activities is becoming significantly constrained.

Dividend to Shareholder

Assumption

PoJL will provide zero cash dividend to the shareholder until such time as it can be regarded as financially self-sustainable, or the directors determine to declare a dividend. Cash contribution to government post incorporation will in the meantime come from 20% corporate tax rate, whilst PoJL will continue to provide the PSOs from within their financial performance.

Justification

A long term assumption within the Case for Incorporation for PoJL is 12.5% of Profit after Tax to be declared as a dividend. Importantly, as we are operating under Companies Law, the declaration of a dividend is the responsibility of the Board of Directors considering the forward obligations on the company.

As SoJ's primary aim of the Incorporation of PoJL was to ensure the long term self-sustainability of the Island's strategic gateways, the Board of Directors would need to have confidence that we are on the trajectory to achieve this before they could consider declaring a dividend.

At this stage the Board of Directors cannot sensibly declare a dividend due to the current situation:

- PoJL have not had a meaningful price increase since Incorporation, and the revenue gap is widening
- PoJL's operational cost base has increased, due to post incorporation costs (eg external audit, legal and parish rates), and increasing costs in those areas where we must maintain operational compliance (eg security and aviation licensing)

Long Term Capital and Funding Assumptions and Regulatory Principles from Incorporation

- The LTCP capital programme remains at c. £400 million, which must be satisfied to keep the ports open, safe and secure
- Commercial projects are delivering results ahead of the original plan, but such projects have long lead times and are not 'givens'
- While progress has been made on a number of legacy items between SoJ and PoJL, most have not yet been concluded

Consequences of POJL's dividend policy

The economic consequences of POJL's dividend policy are important for the economic regulation of the ports. In the absence of dividends going to shareholders, there is no balance that needs to be struck between customers and shareholders - unlike most other UK regulated utilities. As a result, lower prices to current customers will have the following consequences:

- Higher prices to future customers, and/or
- Reductions in the quantity and/or quality of the services that PoJL are able to provide safely and securely, and/or
- Deferring and/or reducing future investments increasing the risk of impacts on services and reducing the resilience to shocks, and/or
- Reductions in the cash holdings of the business reducing its financial resilience, and/or
- The need for a cash injection or other financial support from the States

Unlike most other UK regulated utilities, where the profits from higher prices can be siphoned off to private shareholders through dividends, any profits that PoJL makes is reinvested in the business, to the benefit of customers – either through lower prices to future customers, increases in the quality and/or quantity of services, increased investment or greater financial resilience.

Funding Philosophy

Assumption

Funding for the capital investments will come from a combination of cash generation from core operations and commercial projects, as well as debt funding. Capital investment is 'lumpy', and in any given year there may be higher investment at the Airport or in the Harbours. Therefore we will pool our available funding and allocate to projects across our portfolio.

Long Term Capital and Funding Assumptions and Regulatory Principles from Incorporation

Justification

As described in PoJL's Case for Incorporation, we require a combination of the following items in order to be financially self-sustainable:

- Core revenue growth from increasing volumes and prices
- Efficiency savings from improvements in our operations
- New revenue and returns from investing in commercial projects

As we have an aim to avoid above RPI price increases, we are placing pressure on commercial projects and efficiency gains, but do require price increases in line with RPI to have a chance of being financially self-sustainable in the long run.

Role of Debt

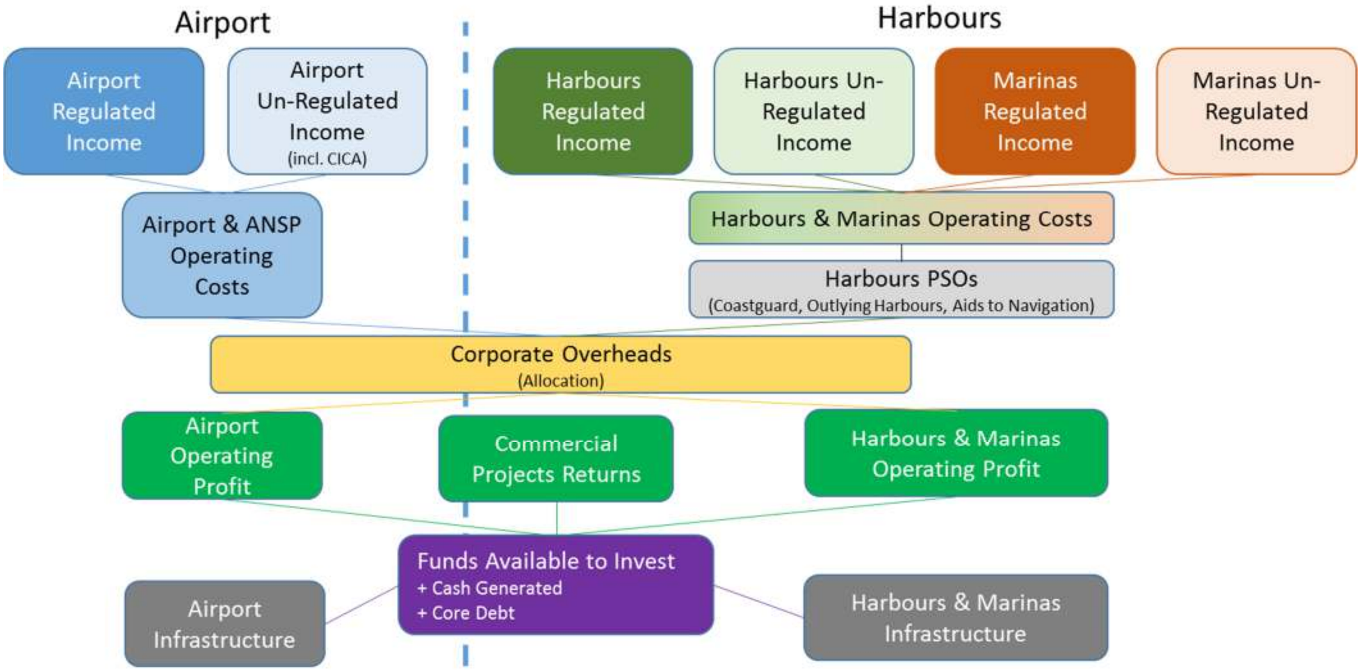
PoJL will also take on appropriate debt to fund our LTCP. Feedback from lenders is that this would be best achieved through an enterprise debt vehicle rather than specific core assets (eg they cannot secure the runway if there is a failure to repay the debt). Further, at the time of incorporation there was some concern from some States Members that PoJL would become too heavily geared.

Hence utilising either a cashflow vehicle (eg Revolving Credit Facility) or longer term enterprise debt vehicles could be used in addition to cash reserves to fund our LTCP investments.

Project specific financing can be used to fund commercial projects, where they will make a financial return after servicing the debt. This has the potential to accelerate commercial projects as they will not need to compete with core investments in the LTCP. Further, lenders would be able to secure against the asset of that commercial project.

Consistent with PoJL's Case for Incorporation, all profits generated by the business, whether they are economically regulated or not, should be put to use to fund our LTCP in the primary instance for Island Benefit.

Long Term Capital and Funding Assumptions and Regulatory Principles from Incorporation



Airport v. Harbour services

Whilst the management of the Airport and Harbour have been fully integrated, we have distinct businesses operating from the facilities in each business unit. We have separate customers and pricing structures in each area.

Over time we would expect harbour users to fund the harbours operation and infrastructure investment, and airport users to fund the airport operation and infrastructure investment. Both areas of Infrastructure investment should benefit from the unregulated returns from commercial projects as well as the enterprise level of debt.

Given the ‘lumpiness’ of infrastructure investment combined with commercial projects that may transcend each operation, we need to pool our funding (both cash and debt) to make investments across all of our operations.

However the regulatory constraints on our prices since incorporation means that we have not had any flexibility to rebalance our prices between our various airport and harbour services to ensure that the revenues from each business better reflects the costs of its operations. We believe that the future regulatory regime should allow us the commercial freedom to rebalance prices to ensure that prices become more cost reflective.

Long Term Capital and Funding Assumptions and Regulatory Principles from Incorporation

Period of Pricing Mechanism

Assumption

10 years, which would provide the necessary foundation to enable long term financial and funding planning for the required infrastructure investments.

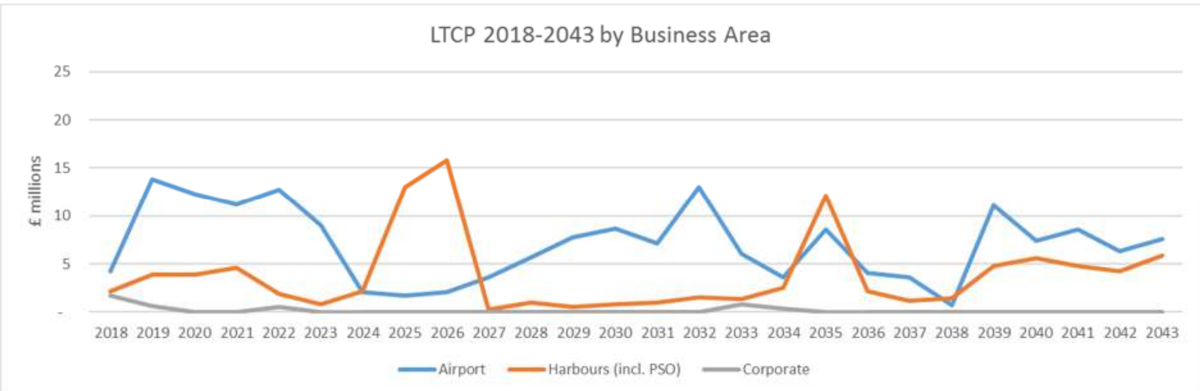
Justification

Since Incorporation in October 2015, PoJL has been submitting annual price increase proposals to CICRA. This is a very heavy and resource intensive process for both PoJL and CICRA.

Creating a mechanism which allows for a more efficient regulatory oversight of PoJL's prices is in the best interest for CICRA and PoJL, whilst at the same time providing much greater stability for PoJL's customers who will benefit from greater visibility into forward prices for the services which PoJL provides.

Infrastructure businesses, such as PoJL, require long term planning in order to ensure we can invest the required amounts in the required assets when they come due.

For the initial price mechanism period, PoJL felt 10 years would be appropriate in order to capture the immediate significant investments at the Airport (Integrated Terminal Development) and Harbour (St Helier Harbour Master Plan). This would effectively be one investment cycle balanced across both activities.



Of course, we must be mindful that initial assumptions can change dramatically over 10 years, for example with the introduction of new or enhanced security protocols or business impact resulting from, say, Brexit. To cover such cases, we would anticipate regular reviews of the actual performance against our assumptions, and there should be an ability to review the mechanism in light of such changes].

Long Term Capital and Funding Assumptions and Regulatory Principles from Incorporation

Appendix B

The Appendix sets out a more detailed explanation of the regulatory principles arising from Incorporation that were summarised in Part 2.

Principle 1: Financial self sustainability

The principle reason for incorporating POJL was to remove a potentially large financial burden from SOJ and allow the commercial freedom to deliver long term financial self-sustainability. As shown in the Case for Incorporation, this could be achieved through delivering a range of commercial projects as well as limiting forward price increases to RPI levels (meaning holding prices constant in real terms).

In the past three years POJL revenues have fallen behind on our core cost base as unit costs have risen whereas prices have not. This is leading to an unsustainable position over the long term, and contrary to what was envisioned in the Case for Incorporation.

Points from the Incorporation documents:

Case for Incorporation, Ministers Forward:

"It demonstrates that, through incorporation, a serious potential fiscal challenge for the Island can be overcome, and enables the Ports to become self-sustainable and make a positive contribution to public finances whilst retaining and enhancing their key role in Island life."

Case for Incorporation, Executive Summary:

"…the primary objective that underpins the recommendation to incorporate the Ports of Jersey, is to enable them to continue to provide the essential public services to the Island, but to do so in a commercial and self-sustainable manner that will both enhance services for customers and remove the significant future financial burden to the States."

Case for Incorporation, Financial Case:

"**The Financial Challenge Faced by Ports of Jersey**

The Ports of Jersey (PoJ) are capital intensive businesses, with a requirement for long-term capital funding totalling £276 million (in 2013 prices) in the period to 2038. This capital investment is required simply in order to maintain the essential infrastructure on which the Ports depend and to enable them to remain open, safe and secure.

Over the past 10 years the Ports of Jersey have experienced declining business volumes and a cost base that is rising faster than revenue. Financial modelling, undertaken as part of the process of preparing for incorporation, suggests a potential cash shortfall of up to £314 million by the end of the financial model period in 2038. Without the positive intervention possible within an incorporated PoJ, such a shortfall could only be addressed through other measures such as price increases including, but not limited to, harbour dues and landing charges, or from subsidy derived from general taxation – in either case, tax-payers and the community would face an incremental and unnecessary burden."

Case for Incorporation, Ongoing Capital Requirements – The Scale of the Challenge

"It should be noted that this assessment, informed by detailed work by Capita Symonds/Validus (see Appendix 4), takes account only of the sums required to maintain existing service levels, and makes no allowance for any enhancements or changes to future service requirements to meet the expectations of users and customers."

Case for Incorporation, Financial Case:

Self-Sustainability Achievable Through Incorporation

In addition to mitigating the above risk of PoJ having to call upon States funding, an incorporated PoJ will provide incremental benefits to Jersey – including a cash contribution of c.£35 million through taxation and dividends. The summary cash flow statement below provides an overview of the benefits that the States could expect to derive from incorporation.

The cash flow statement for the 25 year period shown below, demonstrates the self-sustainability of the Ports of Jersey under an incorporated structure."

POJL Incorporation White Paper from Minister

"The primary objective of incorporation is to enable the Ports of Jersey to continue to provide essential public services to the Island in a sustainable manner, in the face of historic declining business volumes and costs that are rising faster than revenue."

"The government cannot passively accept the £314 million overall cash shortfall that, unless the situation changes, could occur by 2038. To meet this cost from government revenues would mean finding the money through some additional taxation."

Case for Incorporation, current operating structure

"Consequently, the only alternative means of balancing the books would be through passenger (and associated revenue) growth identified in section 4.3 or by a significant reduction in the services offered in order to reduce overhead costs. The latter is neither in the interests of the States, nor in the wider economic or social interests of residents and businesses in the Island."

Regulatory Principle

Throughout the Incorporation Process there was significant and detailed review of the proposition and financial modelling. In all cases price increases in line with RPI was assumed in the discussions and modelling. POJL should therefore be allowed to increase prices to keep pace with the rising cost base (as indicated by RPI) and to make up for the price freeze since incorporation. This should continue until such time as the long term cash flows demonstrate the business can confidently reinvest in its asset base through price increases that are below inflation.

Long Term Capital and Funding Assumptions and Regulatory Principles from Incorporation

When reviewing the long term self sustainability of the business, non-commercial PSO functions that are legal commitments on POJL should be included alongside the costs of the core operations of the business.

Principle 2: Continued provision of non-commercial services

Through the incorporation of POJL, SOJ determined that the company would be required to continue to perform functions of the previous Airport and Harbours departments that would not normally be undertaken by a commercial entity. Rather than burden SOJ to identify general taxation to pay for such services, government compelled POJL to continue to provide these services from within their own resources on behalf of government.

Points from the Incorporation documents:

<u>POJL Incorporation White Paper from Minister</u>

"These documents all serve to support the Minister's five key proposals-

… 2. To ensure that the new entity continues to conduct necessary essential functions for the island that would not normally fall within the remit of a limited company. …"

<u>Case for Incorporation, Public Service Obligations</u>

"The incorporation proposals are underpinned by an overriding assumption that Ports of Jersey Limited will continue to assume responsibility for those key areas and duties that its predecessor currently fulfils today. This means that some of the functions carried out by the new company will be over and above those normally associated with the commercial operation of a port or airport, and may previously have been responsibilities of government."

<u>Air and Sea Ports Incorporation Law, Article 6(1)</u>

"(1) POJL shall be responsible for discharging, in accordance with this Article, the following functions (referred to collectively in this Law as "public service obligations") –

(a) co-ordinating, or providing resources for co-ordinating, maritime search and rescue within the Jersey Search and Rescue Region;

(b) maintenance of aids to navigation in territorial waters;

(c) acting as custodian of Jersey harbours;

(d) enforcement of shipping legislation in territorial waters;

(e) carrying out certain port State control functions;

(f) management of the Channel Islands Control Area."

Regulatory Policy

Recognising that these non-commercial functions are defined in law and are commitments placed on POJL, the policy should include the costs of their provision to the required standards from the core operations of the business when reviewing the long term self sustainability of the business, as ceasing the provision of these functions is not possible.

Principle 3: Service levels and community support

Beyond the Public Service Obligations, it was recognised through the Incorporation process that POJL provided a very wide range of benefit to the Island. These came from the existing service levels delivered through our facilities as well as the deep support that we give to clubs, societies and associations and more generally the community in Jersey. Additionally, through the work that CICRA had performed in respect of service levels, there was nothing identified that we should (or could) stop providing, and more generally pointing to higher level of services.

Points from the Incorporation Documents:

Case for Incorporation, Public Service Obligations

"The Ports of Jersey support many clubs, associations and organisations all of which are connected to maritime and aviation activities. PoJ feel strongly that vibrant and growing clubs and associations are very important for the future prosperity and customer base of the Ports. This principle is a core pillar of our approach on Corporate Social Responsibility.

It is understandable that clubs, societies and associations are seeking reassurance in respect of the perceived changes that the proposed incorporation of PoJ represents. It is therefore, important to state that PoJ intends to continue to follow the existing policy and that no changes are envisaged in respect of either, terms or security of tenure, as a result of incorporation."

Case for Incorporation, Clubs, Societies and Associations

"The Ports of Jersey will continue to support relevant clubs and associations in a similar manner as they do today."

"PoJ have planned for this support activity to carry on through the financial model for incorporation. The assumption contained in the business case for incorporation is that support for clubs and associations will continue as a part of our Corporate Social Responsibility programme."

Regulatory Policy

In terms of service levels and community support, it was anticipated at the time of incorporation that POJL would behave and perform in a similar manner post-incorporation as it did pre-incorporation. Service level reductions and ceasing community support should be avoided, and could continue at pre-incorporation levels should POJL be confident in long term self-sustainability of cash flows, which included RPI level price increases.

Principle 4: Effective and efficient port operations

The provision of open, safe and secure gateway operations is paramount. POJL are operationally regulated to international standards, where they must be compliant to operate (and in many cases eg security screening, the scope and therefore costs of these standards in increasing). Within this context, it is important to ensure the operations of the facilities and services are performed as efficiently as possible within the operational and social constraints of the operations in the Island. Up to 90% of the cost base of the business is largely fixed in the long term, and subject to inflationary cost increases. Presuming operational compliance is a baseline requirement, efficiencies would largely have to come from service level reductions. Staff were transferred over on terms that protected their roles and terms and conditions of employment.

Points from the Incorporation Documents:

Case for Incorporation, Historic Performance

"The Ports have managed to minimise the impact of increasing costs and reducing revenues in recent years, primarily through pursuing ever greater efficiencies and through the delivery of initiatives that have helped to support the overall financial position. These efficiencies and the associated improvements in working practices have been achieved largely as a consequence of the integration of the Harbours and the Airport. However, improvements in efficiencies of this scale are unlikely to be repeatable without having to resort to a significant reduction in services, and consequently, it is clear that the position is unsustainable in the medium to long term."

Case for Incorporation, Staff Transfer

"The key principles contained within the TOPSE agreement, which has been based upon an overriding principle that roles and role-holders transfer across on a like-for-like basis, are as follows:

• There will be no redundancies as a result of the process of incorporation

• There will be no requirement for existing employees to apply for their current roles, nor will there be any probationary period

• All current employees will be transferred on their existing pay, terms, conditions and main policies and procedures. Importantly existing employees will continue to participate in the Public Employees Contributory Retirement Scheme (PECRS). This provision is an improvement on UK TUPE legislation which does not provide any pension protection

• Employees who do not wish to transfer to the new entity, will be deemed to have resigned. This is in line with TUPE legislation."

Case for Incorporation, Implications of Non-incorporation, Service Reduction

"In order to reduce costs, one option that the Ports of Jersey could take is to either cease or reduce the range of products and services provided or resort to increasing prices. However, any such actions would be viewed negatively by the population and customers of Jersey, lead to a loss of confidence in Jersey by key operators and also have a potentially negative impact on the reputation of the

Island. In addition, any cessation or reduction of services would be likely to lead to a reduction in the size of the organisation."

Regulatory Policy

POJL have made efficiency improvements during both their pre- and post-incorporation periods. However, with the operational compliance constraints and an undertaking to maintain service levels from the incorporation process, significant improvements in the cost base is unlikely in the medium term. Therefore, the policy direction should be to (at minimum) maintaining the funding of existing services levels and operational compliance.

Principle 5: Price levels

The period prior to the incorporation of POJL was hallmarked by costs rising faster than revenue, given prevailing pricing policies of the day, as well as under investment in the asset base of the gateways infrastructure. Commercialisation of POJL enables revenue additive activities to take place, however these take time to achieve scale and by their nature have an element of risk. In order to protect the services and facilities operated by POJL, it has been a long held assumption that RPI-level price increases on the core operations would be required (i.e. prices would be held constant in real terms).

Points from the Incorporation Documents:

Case for Incorporation, Executive Summary

"Importantly, incorporation will reduce the potential dependence on significant price increases and / or States funding to satisfy future capital requirements."

Case for Incorporation, Benefits for Customers

"Deriving incremental revenues from the assets, and successfully diversifying revenue streams will help Ports in its efforts to minimise the risk of above inflation increases to the fees and tariffs levied on commercial customers."

Case for Incorporation, Financial Model Assumptions

"There are no above Jersey RPI price increases in relation to the pricing of services"

Case for Incorporation, Historic Performance

"Business volumes have declined since the recession of 2008, whilst historically, government policy has tended to be designed to keep any increases in harbour dues and landing fees at low levels, with any rises that have been implemented being restricted to below Jersey RPI. Indeed, as business volumes have declined in recent years, there has been a deliberate policy in the case of the Airport to hold prices in order to seek to encourage increased visitor numbers.

Consequently, the combination of restricted increases in fees and dues, at a time of decreasing volumes and rising costs, has created an unsustainable position"

Case for Incorporation, Financial Modelling Scenarios

"If the Ports continue to operate in the same manner as they have done in past years, a shortfall will arise that will need to addressed, through price increases well ahead of inflation, general taxation, or a combination of the two."

Regulatory Policy

The principle would be for POJL to increase regulated prices at or below RPI which would be accepted by default. Larger or more complicated price increases would follow a more detailed regulatory approval process.